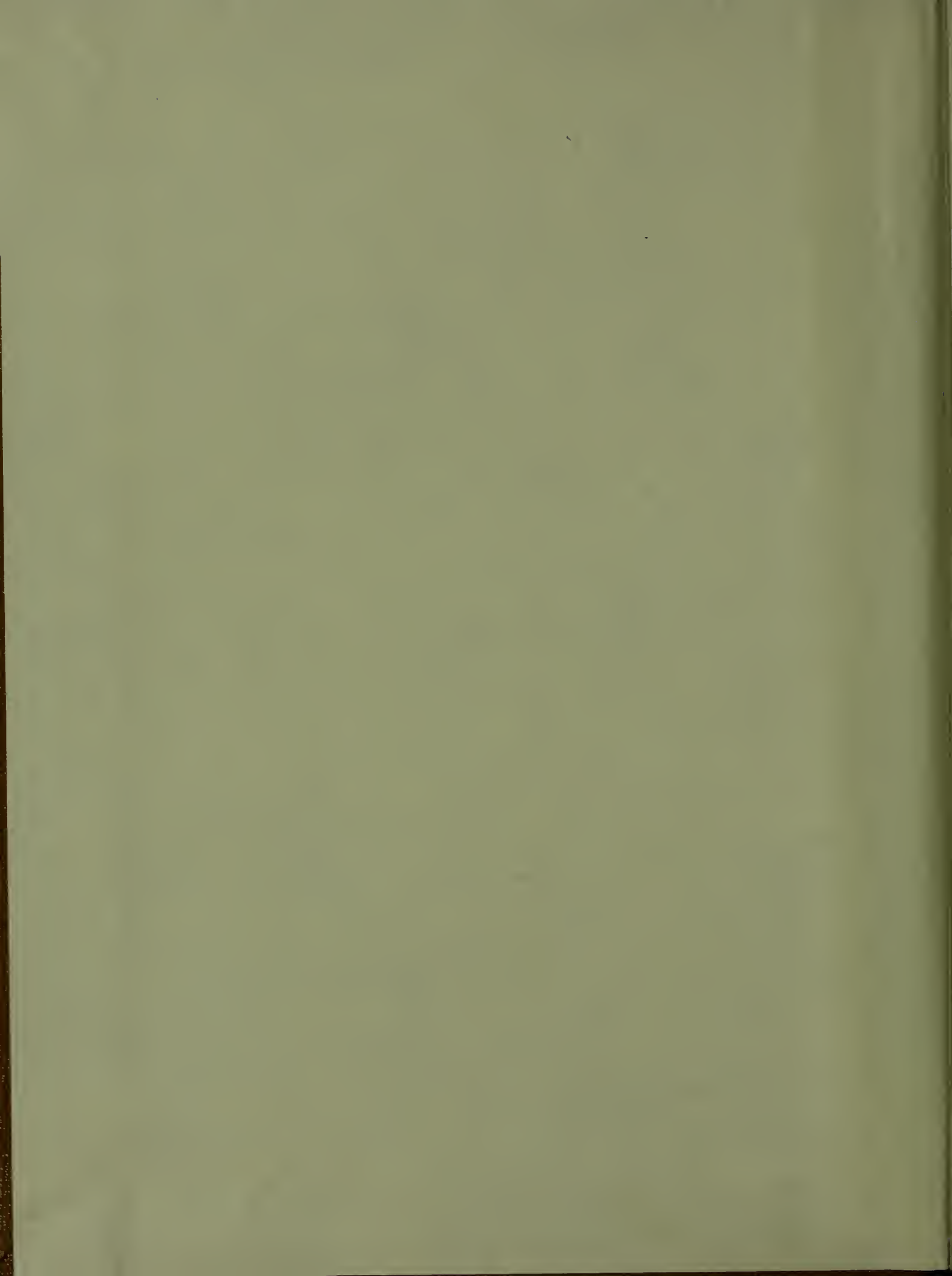
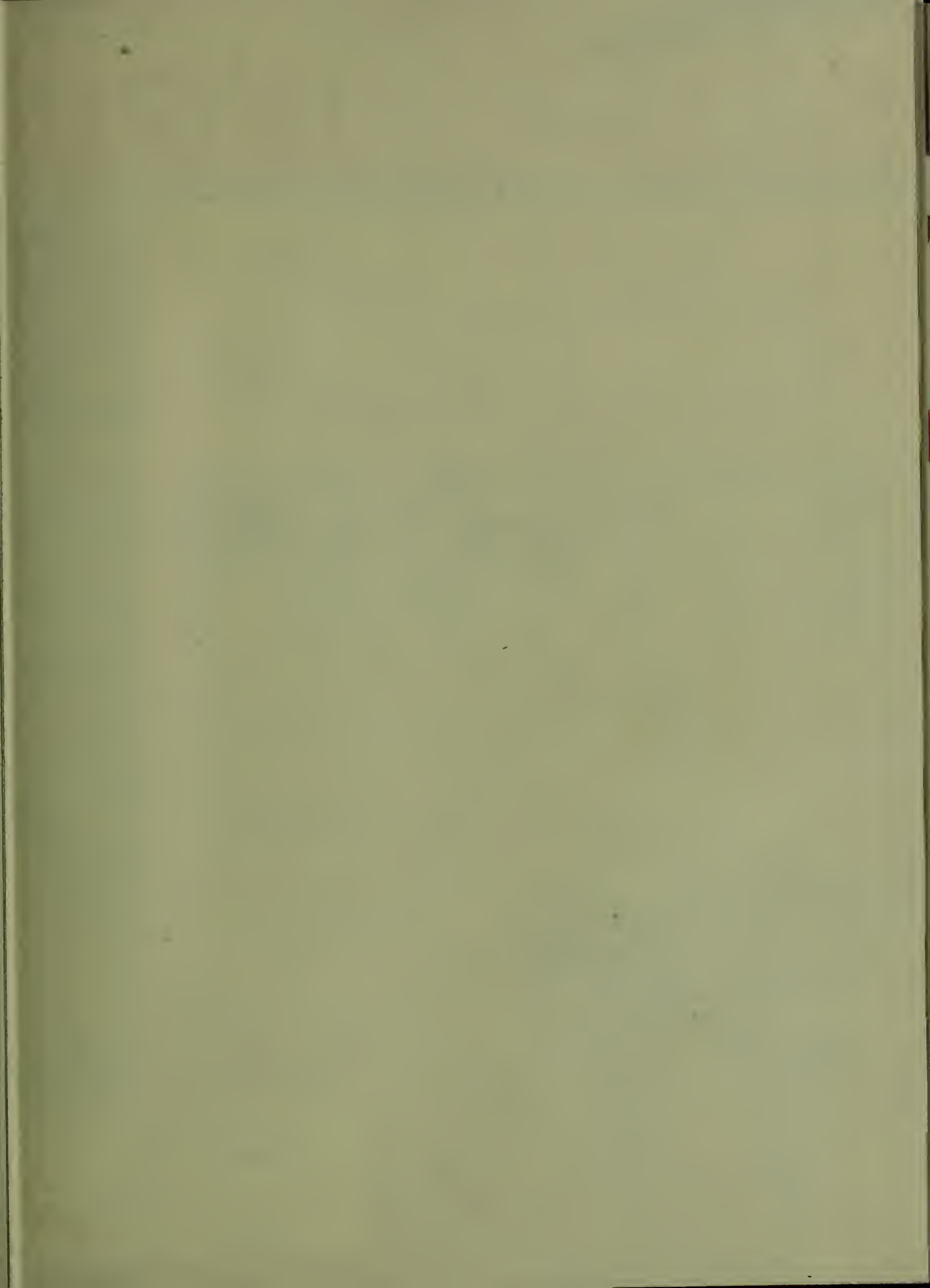




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BusinessWeek

November 4, 2002

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The Painful Truth About PROFITS

Yes, earnings are up. But high labor costs, slow global growth, and serious overcapacity leave little running room for CEOs. Look for massive consolidation and brutal job cuts ahead. It won't be pretty.

BY MICHAEL J. MANDEL



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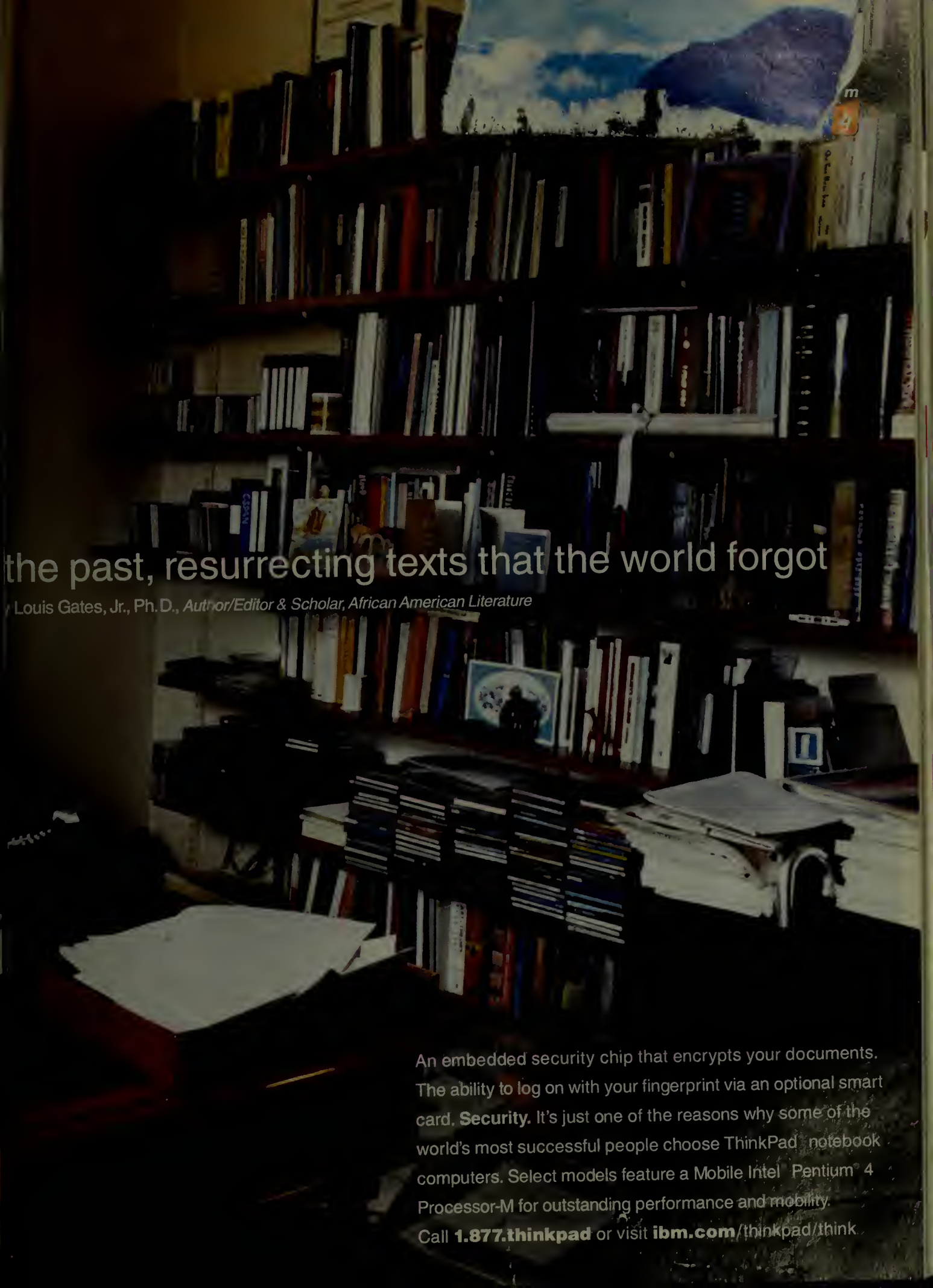
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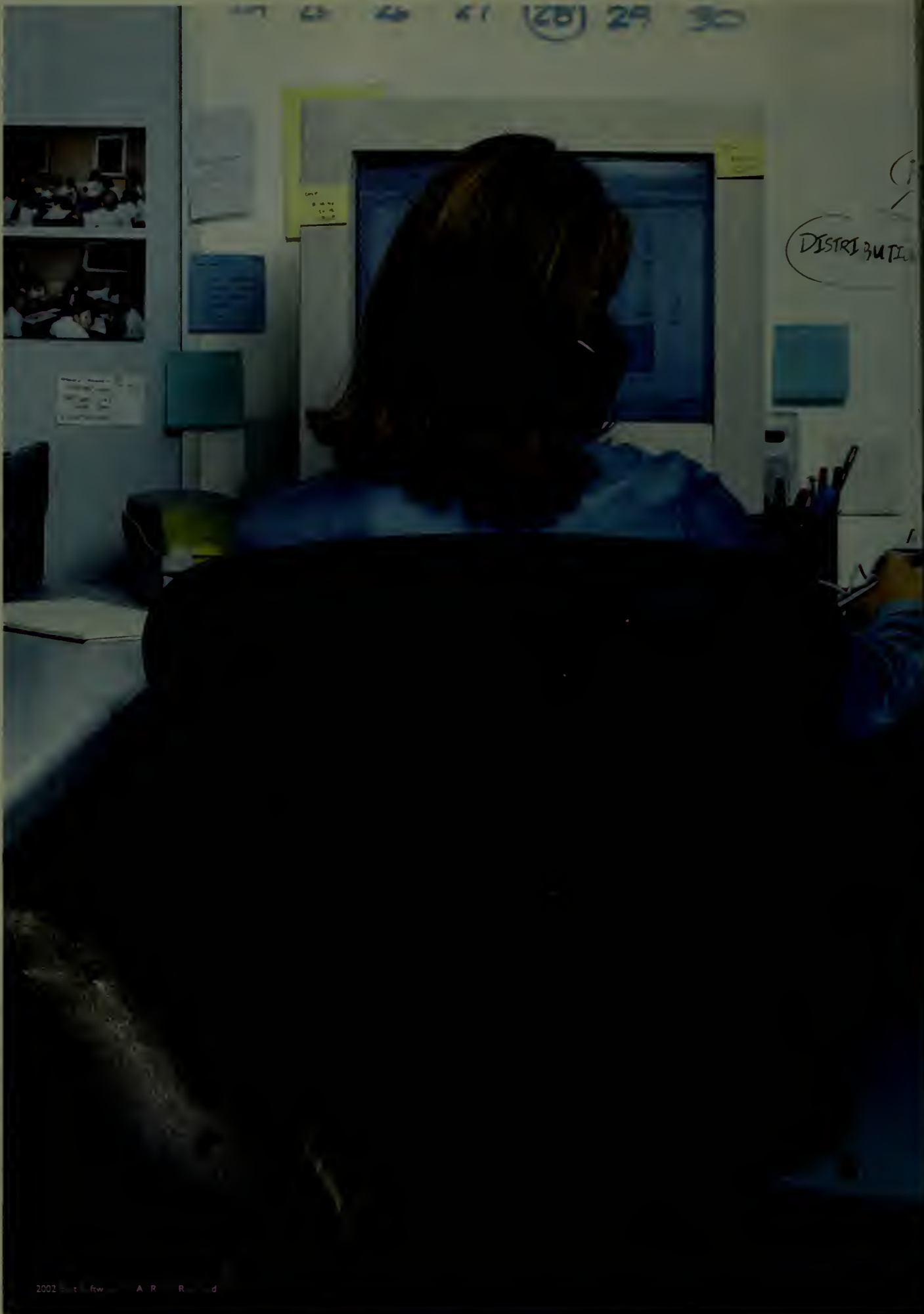
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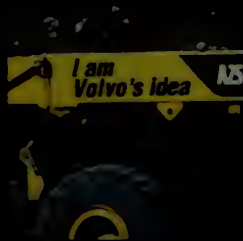
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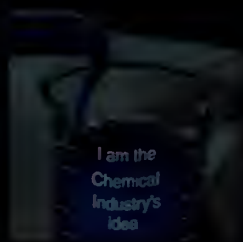
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COVER STORY

PROFIT PAINS

Corporate America must slash more costs before earnings rise very far page 106

BusinessWeek

NOVEMBER 4, 2002

QWEST QUEST

Trying to figure out what Phil Anschutz knew, and when page 114



Cover Story

106 PROFITS: THE PAINFUL TRUTH

Powerful forces continue to work against the restoration of corporate profits. Manufacturing capacity, already overbuilt, is still growing, undermining pricing power. And the weakness of economies overseas are a drag on sales. While profits could well rise next year, executives are going to have to make deep job cuts to get there. As business investment strengthens, such massive layoffs are likely to sour the environment for households. Bottom line: America may be headed for a growth recession

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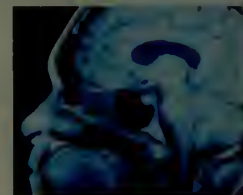
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Medical Miracles

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Up Front

EDITED BY SHERIDAN PRASSO

DARK DAYS

IN THE SNIPER ZONE, DELIVERIES RISE



SHOOTING SCENE: Empty strip malls

THE WASHINGTON SNIPER HAS many people too scared to go out to restaurants—or even to the grocery store. Shops, particularly those in strip malls and with large parking lots, report that business is down by 25% since the first attack on Oct. 2.

As a result, grocery and take-out delivery services have seen a sharp rise in sales, forcing them to add

new workers to meet demand. Because companies don't want to be seen as profiting from death, it's difficult to quantify all this.

Yet grocery deliverer Peapod by Giant, for example, says it's now taking so many orders that it needs to add 20% more drivers and trucks. Consumers can't get their groceries right away anymore: Peapod's delivery dates are pretty much booked solid several days in advance.

And just imagine how many Domino's pizzas are being ordered these days, though the company declines to say.

Takeout Taxi, which delivers food from 125 restaurants to residents in Montgomery County, Md., reports that orders are up 20%. Drivers say that tips are higher, too. Says Takeout owner Richard Baran: "People really appreciate that our drivers are doing this." *Laura Cohn*

THE LIST PAYBACK TIME

Suits by regulators over recent corporate scandals are resulting in an increasing number of fines. Here are some high-profile cases:

COMPANY/DATE	FINE	EXPLANATION
ARTHUR ANDERSEN October	\$500,000	Found guilty of obstruction of justice for shredding Enron-related documents. Also sentenced to five years probation.
CITIGROUP September	\$5 million	Settled allegations that star analyst Jack Grubman issued misleading research.
MERRILL LYNCH May	\$100 million	Settled allegations of conflicts of interest between investment-banking and research departments.
CREDIT SUISSE FIRST BOSTON January	\$100 million	Settled allegations that IPO shares were doled out unfairly.

Data: *BusinessWeek*

FINED

TALK SHOW "We have every confidence in Ron."

—Bausch & Lomb lead director William Waltrip, after *TheStreet.com* reported that CEO Ronald Zarrella did not have an MBA, as claimed on his résumé

GREEN WATCH

CLEANER AIR—KYOTO OR NOT

PRESIDENT BUSH MAY HAVE rejected the Kyoto Protocol, but U.S. companies don't have the luxury of sticking their heads in the sand over global warming.

Multinationals will have to meet restrictions on carbon dioxide emissions already being imposed in Europe. And as 185 nations currently meet in New Delhi to discuss steps beyond Kyoto, many U.S. execs believe similar curbs could be coming here, too. Such cuts "are very likely a reality all over the world," explains DuPont Vice-



President David Fin "The sooner you start aging your business with in mind, the better off will be."

That's why U.S. companies are experimenting with emissions-trading programs modeled after the system already used to cut sulfur

dioxide pollution. In a pilot program called Chicago Climate Exchange, scheduled to launch in 2002, companies will trim their emissions or credits from others. Meanwhile, energy and environment broker Natsource

building a carbon "bank." Companies would deposit emissions cuts and get credit for them under various trading plans. *John Co*

SEPTEMBER 11

HOW AIR FORCE ONE LET BUSH DOWN

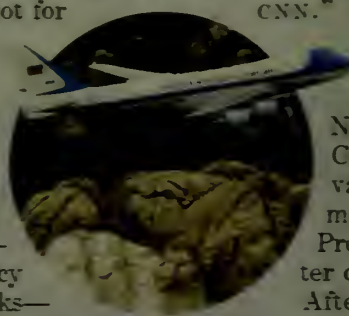
PENTAGON OFFICIALS PREFER not to talk about it, but Air Force One isn't as high-tech as you might think. The communications equipment on the President's plane was chosen for its ability to withstand a nuclear attack, not for its capabilities. And now, more than a year after the September 11 attacks, the sad state of Air Force One communications—and its inadequacy during the attacks—is starting to leak out.

While being flown to safety on September 11, President Bush was unable to hold a videoconference in flight, adequately monitor news coverage, or receive necessary data from key people on the ground. "The President was not happy," Admiral James

Ellis Jr., commander of U.S. military's Strategic Command said, according to *Aviation Week* (which, *BusinessWeek*, is a unit of The McGraw-Hill Company). "He couldn't even watch CNN." Once Bush arrived

Offutt Air Force Base in Nebraska, Strategic Command's more advanced equipment put the President in better communication. After September

11, money was immediately allocated to upgrade four Presidential planes. To cost will be less than \$50 million, and two are now finished, says Air Force Colonel Robert Hudson. No one wants an unhappy President—much less an out-of-touch one. *Kimberly Weiss*



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Up Front

jumped 80% in the first half of this year, the Philippines' exports to China nearly doubled, and those from South Korea, Malaysia, and Thailand have all seen double-digit growth.

Overall, sales to China from the rest of Asia could increase 55% to 85% by 2005, according to Salomon Smith Barney. "China is providing some of the best opportunities for economies in the region," says Philippine Finance Secretary Jose Isidro Camacho.

That's a good thing, because the U.S.—which is still Asia's top export market—has been in the dumps. In the first half of this year, exports to the U.S. from Taiwan, the Philippines, and Japan all dropped by more than 5%.

Sure, some of these exports to China still pale in comparison with those to the U.S. But maybe not for long.

Frederik Balfour

TRADE WINDS

CHINA: KEEPING ASIA ALOFT

CHINA IS STARTING TO OVERTAKE the U.S. as the locomotive for economic growth in Asia. Already, it has unseated the U.S. as Taiwan's No. 1 export market, and last year it eclipsed Japan as South Korea's second-largest export destination, after the U.S. Indeed, insatiable Chinese consumers are gobbling up cars, chips, and just about anything else the rest of Asia can make.

The numbers are striking: Taiwan's exports to China

SPORTS BIZ

FANTASY TEAMS, REAL PROFITS

KEEN TO OWN A SPORTS franchise but a few hundred million shy of what it takes? There's a modestly priced alternative: a sports fantasy franchise. For about the price of dinner for two at the stadium, fantasy team owners can draft players and juggle lineups like real owners, either on their own or by joining leagues.

Once a cult activity among sports fanatics, fantasy games are going mainstream. About 15 million Americans now play fantasy football, baseball, basketball, hockey, or auto racing—up from 4 million in



GOING LONG Online

1994, according to the Fantasy Sports Trade Assn. About half of them are doing it on the Web, playing for free on some sites and paying up to \$250 a season on others, including ESPN.com, SportingNews.com, SportsLine.com, and Yahoo.com. On Oct. 22, SportsLine doubled previous revenue estimates

for this year for its most popular game, Fantasy Football, to \$8.5 million, in its first year of charging members to play. "People love demonstrating their knowledge of football, even arguing about it," says SportsLine

CEO Michael Levy. "There's not a better way than by owning a fantasy team." Unless you can scrape up \$700 million for the real thing, that is.

Mark Hyman

DRAWN & QUARTERED



ELECTION 2002

THREE TIGHTWAD AMIGOS RIDE AGAIN

IN 1994, THREE RENEGADE Republicans were elected to the House of Representatives as part of the GOP class that broke 40 years of Democratic



SANFORD



LARGENT



GRAHAM

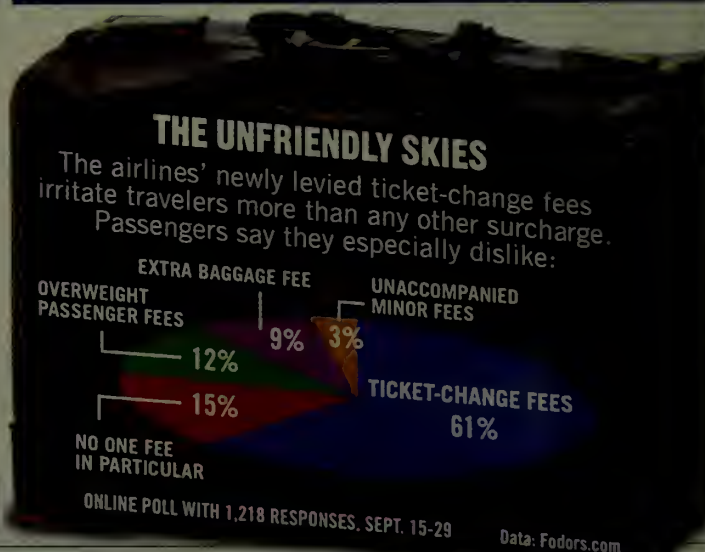
particular, took frugality heart: During his six years in the House, he actually lived in his office. In part because of their shared ideologies they became personally close. Graham and Largent (a National Football League Hall of Famer) are godfathers Sanford's youngest son.

Largent and Sanford have since left Congress, but the three are back on the campaign trail this year—seeking higher office. Largent of Oklahoma, and Mark Sanford and Lindsey Graham, both of South Carolina, quickly earned reputations as fiscal conservatives who didn't mind voting against party leadership to hold the line on government spending. Sanford, in

Graham wants to succeed Senator Strom Thurmond (D-S.C.). Largent and Sanford are running for governor. Largent, at least, is likely to win his seat—he came out of the GOP primary in Oklahoma with nearly 90% of the vote.

Alexandra Stamaty

THE BIG PICTURE



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Readers Report

TALLYING THE VALUE OF MERGERS

"Mergers: Why most big deals don't pay off" (Cover Story, Oct. 14) was insightful but missed two reasons for so many large, senseless mergers. First, mergers trigger "change of control" provisions in executive-compensation plans of both companies, thus allowing the execs on both sides to profit immediately—through the acceleration of their stock options and deferred compensation—regardless of how the merger ultimately turns out.

Second, the investment bankers receive huge cash fees for putting the merger together, no matter what transpires. In fact, the same investment bankers are sitting by waiting to make more fees to help "unwind" ill-advised mergers later on.

William S. Lerach
San Diego

Efficient-market theory is an even more fundamental reason for why most deals don't pay off. In efficient markets, the value of a company is the result of the average of millions of shareholders' opinions on what a stock is worth. In a merger, a group of consultants and managers get together and decide that they know the value of the company better than shareholders. Millions of shareholders believe that the acquired company is worth X, the management think it's worth 40% more than X. Is it any wonder most mergers fail?

David Reid
Manchester, N.H.

If most mergers fail, might part of the problem be all those unneeded peo-

ple who carried organizational memory in their heads?

Gary R. Gut
Highland Park, Ill.

The average buyer's one-year return over peers for your 15 "Big Deals" was 1.4%, and for all buyers paying cash was 0.3%—i.e., on average all Big Deal did pay off, as did all cash deals. The 8% decline by companies using stock was not large and was to be expected—the use of stock implies a company believes its stock is overvalued. The 1

"Big Losers" were concentrated in software (6), retail (3), and other tech (2). Factoring in the 36% premium to acquired companies' shareholders, who sell immediately to merger arbitrage managers, mergers have been very good for shareholders overall.

Seth P. Washburne
Washburne Capital
Management
New York

Editor's note: The writer's firm is a merger arbitrage fund.

Yes, there are a number of "serial acquirers" that, along with their shareholders, regret their overzealous buying. But there are also many blue-chip companies that created huge value for shareholders through M&A—GE Capital, Unilever, General Dynamics, Citigroup and Danaher, to name a few. Ironically the increasing reluctance of many boards to consider M&A in light of the failures of the 1990s has created a buying opportunity for well-managed, disciplined companies with strong balance sheets. While many of the serial acquirers from the past decade are on the



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Readers Report

CORRECTIONS & CLARIFICATIONS

In "The best B-schools" (Special Report, Oct. 21), the table "How the report card gets graded" misspelled the name of Kelley, Indiana University's Business School. Also, the descriptions for Emory University and Michigan State University were reversed: They should have read as follows: Emory: Student satisfaction soared after a revamp in curriculum and refocus on the "experience" of attending B-school. Recruiters also noticed improvement. Michigan State: Grads say placement office is the best in helping them prepare for job interviews. Leaps from No. 26 in 2000 recruiter poll to No. 17.

sidelines trying to digest their acquisitions, it doesn't mean the rest of Corporate America should be fasting.

Eric Armour
Marakon Associates
New York

Post-bubble bulletin: Earnings anemia
Can bring on corporate bulimia.
Can't keep down everything that you
bite off?

Spin off! Sell off! Kill off! Write off!
Reflex responses to burning question:
How to cure asset indigestion.

Andrew Sprung
South Orange, N.J.

MAKING THE POOR POORER

"Global poverty" (Special Report, Oct. 14) notes that "the IMF [International Monetary Fund] and the World Bank, whose prescriptions often work better in theory than in real life, still wield too much power." In fact, the loan conditions set by these lenders often call on poor countries to implement the exact opposite of the policies used successfully by all of the world's industrialized countries, including those in East Asia.

Rick Rowden
Alexandria, Va.

The remedies you suggest—education, health care, and ownership of property—are all obviously right. However, without health care that includes voluntary family planning, these other things are futile.

Jean H. Stuart
Edina, Minn.

Your splendid account would have been more bird's-eye, rather than worm's-eye, if it had included the over-

all numbers of those classified as being in poverty worldwide—defined by the World Bank as earning less than \$1 per day. Those numbers peaked at 1.4 billion in the late 1980s and declined to 1.15 billion in 1999. A broad regional breakdown would have shown how variable poverty is in the world, with openness to trade an additional factor.

Herman I. Liebling
Bethesda, Md.

WHY CEOs WON'T BE ANY HELP

Jeffrey E. Garten is right on target ("A foreign policy harmful to business," Book Excerpt, Oct. 14). However, I see one problem with asking America's top CEOs to work together to moderate Washington's unilateralist policies: Many CEOs are themselves skilled practitioners of corporate unilateralism.

Bob Emiliani
Hartford

THE VIEW FROM EL PASO

"The energy watchdog finally barks. But will it bite?" (Washington Outlook, Oct. 14) appears to assume that El Paso Corp. manipulated the markets in California and has been convicted of doing so. Nothing could be further from the truth. At all times, El Paso transported as much gas as possible consistent with safety and operational considerations.

We are confident that when the Federal Energy Regulatory Commission and the courts review the facts and the law, our safe, prudent, and legal operating standards will be supported.

William A. Wise
Chairman & CEO
El Paso Corp.
Houston

A BETTER READ ON HOW SCHOOLS ARE DOING

Schools cannot do their job under intolerable conditions ("Closing the school gap," Social Issues, Oct. 14). The California legislature is studying a new master plan that includes an Opportunity To Learn Index. The index will not only reflect what teachers taught but will also inform the public whether students had qualified teachers, adequate textbooks and materials, a curriculum aligned with state standards, and a safe, clean environment. When published alongside the Academic Performance Index (measuring scores on the Stanford

9), the index will let the public see effects of funding on achievement.

Walt Gardner
Los Angeles

SIMILAR CREDIT RATINGS, DIFFERENT RISKS

"Getting to the bottom of a company's debt" (BusinessWeek Investor, Oct. 21) explains that a credit rating should provide a consistent indication of the likelihood of default. Although it may be true for companies, the same cannot be said for municipal ratings. The rating agencies have done studies showing that a corporate entity with a given rating has a default probability at least 10 times greater than a similarly rated municipal entity.

Peter Ghavani
Managing Director
UBS PaineWebber
New York

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Hungary

Europe's premier performer plans further growth



The investors' favorite: three reasons why

Over the last 12 years, the world's companies have invested more than \$25 billion in Hungary. That's a huge amount for a country of 10 million. Here's why.

No walls.

Hungary systematically dismantled all barriers to international investment in such key sectors as banking, communications, utilities and manufacturing—and built central and eastern Europe's most advanced business community.

No rigidity.

Hungary returned to democracy and a free market economy in 1990. Since then, the country has had three national elections. Each brought a change in power—and the pursuit of the country's pro-business, pro-openness, pro-Europe policies.

No waste of money.

Hungary fast-tracked approval and site and personnel supply systems—and reduced times to investment return which are among the shortest in the world.

THE FIRST IN A THREE PART
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Hungary recently announced that it would implement a new economic plan. This news took the rest of the world by surprise.

The surprise was entirely understandable. The rest of the world was still marveling at the wonders wrought by the previous plan, which transformed Hungary into one of the industrialized world's fast-rising stars. No country in central and eastern Europe—and very few in the world as a whole—has grown as steadily and strongly as Hungary over the past eight years.

This upswing has elevated Hungary into one of Europe's leading providers of high-end capital goods and technical services. The upswing has also slashed unemployment and inflation to enviably low levels, has boosted corporate and personal incomes, and has put Hungary at the forefront of European and trans Atlantic unity.

Making these results even more remarkable is that they have been achieved while the economies of the EU (with which Hungary now conducts more than two-thirds of its trade), the USA, Russia and Hungary's other major economic partners have sputtered.

The results recorded and the resiliency shown by Hungary's economy have caused the rest of the CEE region to adopt the key features of the country's economic plan—also with commendable results.

Compounding the surprise: the previous plan was showing no signs of losing its effectiveness. Thanks to it, Hungary looks set to record a further, 3% to 4% rise in GDP in 2002.

The question arises: why scrap a winning approach? "We didn't scrap the previous plan. Rather, we further developed it. Over the past eight years, due to the previous plan, Hungary's situation has changed profoundly and positively,

and this new situation called for a new approach," explains István Csillag, the country's minister of economic affairs and one of the plan's mentors.

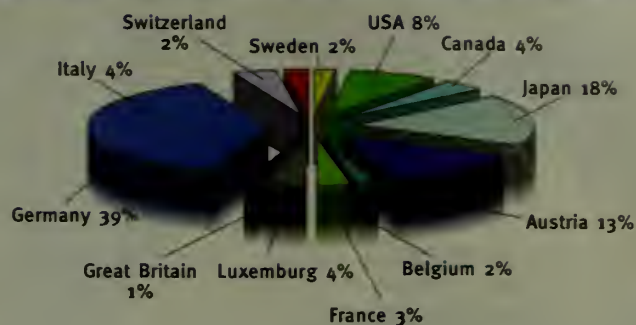
"The new plan retains all of the elements of the previous one including its uncompromising insistence on making our country the smartest in Europe, the smartest at securing international investment, the smartest in using that to build an advanced business base and the smartest in helping our companies sell these advanced products and services abroad," notes the minister. He adds: "To show that we have retained the focus, we have christened the new plan 'Smart Hungary.'"

As the minister explains, the center of Hungary's "smartness" is greater Budapest's cluster of universities and research institutes (many owned by multinationals). It is here that the bulk of the country's market-making products and services are developed, here that many of the managers, scientists and technicians staffing the companies manufacturing and providing these items are educated.

To foster the country-wide spreading of this smartness, the new plan furthers the forming of clusters in five other Hungarian metropolises. To ensure that investors will settle in and around these clusters, Smart Hungary has established a stock of sites. These are to be leased to investors.

"This arrangement minimize investors' up-front capital expenditures," notes Csillag. "To encourage them to ramp output at the facilities built on these and other sites in our country, we have instituted a new system of investment incentives. Conforming to EU directives, these incentives reward output and value creation," the minister states. »

FDI in Hungary-2001



Source: Ministry of Economic Affairs

International investment in 2002: The multinationals are homing in on Hungary

Each year, the world's companies are called on to rate the competitiveness of the countries in which they do business. Of late, Hungary has been steadily rising in these rankings. Should present trends continue, it will crack the top 20 next year, placing it in pretty select company.

Companies assess national competitiveness in another, very practical way: in their selection of sites for key facilities. And here Hungary would seem to be near the very top of the world in competitiveness, as several recent selections show.

Life sciences: very much alive in Hungary

General Electric's pursuit of excellence has made it one of the world's most admired companies. One of the main venues for this—very successful—pursuit is the life sciences sector, itself, along with automobiles, one of the business world's best long-term performers.

On May 27, 2002, General Electric Medical Systems announced plans to build a facility in Budapest. The facility will develop and manufacture state-of-the-art X-ray systems.

Significant about the investment were the reasons given by GE, with literally the entire world to choose from, for locating its new facility in Hungary.

"Our decision to base our newest global center of excellence in Budapest is the direct result of our ability to locally recruit the superior technical talent needed to develop and commercialize the world-class, high-technology products in our portfolio," states Reinaldo Garcia, president and CEO of GE Medical Systems in Europe.

The quality of the country's brainpower has led GE to commission or launch no less than three other such facilities in Hungary during the last year. These facilities have brought the company's total investment in the country to \$1.1 billion.

In addition to medical systems, GE's operations in Hungary develop, produce and service illumination systems, power plants, jet engines, and industrial controls, and software.

Joining GE in setting up advanced Development and Manufacturing (D&M) facilities in Hungary have been IBM, Nokia, Philips, Siemens, Glaxo-Wellcome, and many others.

Fast cars from fast-growing manufacturing facilities

Recession or not, high performance automobiles continue to sell very well. A large number of the sleek coupés and sports cars so prized by the world's auto-lovers stem from Hungary.

Case in point: Audi. On August 28, 2002, the German manufacturer commissioned a Euro 135 million extension of its facility in Győr. The new halls will turn out the powerhouse of Audi's fleet of engines: a 4.2 liter, eight cylinder job. The latest investment brought Audi's outlays in Hungary to over Euro 1.4 billion.

These investments have made Győr one of Audi's major centers of production. In 2001, Audi's facilities in the western Hungarian city turned out 1.2 million engines and 50,000 completed vehicles.

Joining Audi in locating major facilities in Hungary have been Ford, Suzuki, and Opel. They, in turn, are but a few of the 25,000 foreign companies which have set up production, distribution, administrative, and logistics facilities in Hungary.

Designed by dotCOMMS.net



The Republic of Hungary

Facts and Figures

Area: 93,000 square kilometers

Population: 10.25 million

Capital: Budapest (1.93 million)

Other major cities: Debrecen (210,000), Miskolc (182,000), Szeged (169,000), Pecs (163,000), Győr (131,000)

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MEMOIRS

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THE POWER AND THE PRIVILEGE

During his half-century career, David Rockefeller became America's preeminent banker-statesman. As chairman of Chase Manhattan Bank, he presided over an empire that stretched from São Paulo to Moscow. He carried missives for Presidents, negotiated with potentates, befriended the exiled Shah of Iran when no one else would, and possessed an electronic Rolodex with the names and numbers of 100,000 important people. Out of a sense of civic commitment, he took the lead in developing modern Wall Street, Battery Park City, and the World Trade Center. He was every bit as public a figure as his politician brother Nelson, and internationally better known. But except for *David* by William Hoffman, a thinly disguised 1971 hatchet job on him, he has never been the subject of a book.

Now, Rockefeller's 500-page autobiography, *Memoirs*, gives us an inside look at the man and his complex career. There's no dirt-dishing or score-settling here. Nelson's scandalous death in the arms of a young assistant, for example, gets passed off as an "unfortunate episode." In most ways, however, this is a revealing, forthright account of how a young man bearing the Rockefeller mantle of power, privilege, and responsibility came of age as America itself was becoming a dominant world power.

Born in 1915, Rockefeller inherited his sharply etched "Aldrich nose" from his mother. From his father, he learned humility. He knew his family was rich, but despite such privileges as a 90-room "cottage" at Seal Harbor, Me., he often didn't feel so prosperous. Along with four of his five brothers, he was sent to a modest New York day school. Later, while at Harvard College, David got a letter from his father warning that he might have to "work for a living."

At 19, he suddenly inherited \$16 million (\$216 million in today's money). The

abrupt windfall—one of seven family trust funds—was arranged by his father to avoid the Roosevelt Administration's confiscatory federal estate taxes. Smart lawyers sheltered the family fortune so well that it still showers funds on successive generations. But the lawyers also made sure heirs didn't get their hands on any real money for years. David's initial income of \$2,400 a year left him sometimes feeling "broke." Once, when he asked his father for more, he got a check for \$400—accompanied by a stern letter.

Youngest of the five brothers, David was the only one to earn a PhD. His professors were a pantheon of the economics elite: Joseph Schumpeter at Harvard; Marxist Harold Las-ki, libertarian Friedrich von Hayek, and Lionel Robbins at the London School of Economics; and Frank Knight and Jacob Viner at the University of Chicago. In 1940, he landed his first job, drafting replies to letters sent to New York Mayor Fiorello LaGuardia at a salary of \$1 per year. Then, told by his mother to do his duty, he enlisted as a private in the U.S. Army and went on to set up a World War II intelligence network in Algeria.

After the war, he returned to New York and Chase, where his uncle, Winthrop Aldrich, was chairman. It took the younger Rockefeller 23 years to become chairman, in 1969. His rival was George Champion, a crusty credit man who had a barely disguised disdain for the young scion. And Champion often won. The board back-burnered David's plans for making Chase a global bank. Meanwhile, crosstown rival National City—today's Citibank—was slapping up offices abroad and pioneering new products at home. When David finally

got his chance in the late 1960s, brought all of the clout of Rockefeller Inc.—including his first-name acquaintance with world leaders—to make an overseas push, rolling out some branches in a decade. He writes of special triumph in seeing astonished Muscovites turn out to see the "Rockefeller Bank" open a branch in Russia. Sadly, he admits, it never made money.

But his life was hardly all business. Beginning in the 1950s, David was claim a place among the postwar establishment that ran America and much of the world. Many of the leaders, from John J. McCloy to McGeorge Bundy, were Rockefeller family associates. Others, such as Henry Kissinger, were retainers. Europe and Japan were viewed as market opportunities rather than

rivals. There were no corporate raiders, and profit maximization wasn't yet part of the boardroom vocabulary. Within this club, CEO didn't just run his company, he could afford to be a patron, civic leader, and rising ambassador.

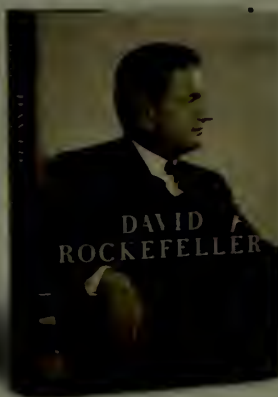
Treating Chase as if it were on auto-pilot ultimately led to trouble. By the early 1970s, Chase's real estate lending, bond losses

and massive computer woes had landed it on the Comptroller of the Currency's problem-bank list. Citi was there, but its prognosis was better. So while juggling numerous other duties, David Rockefeller also had to rescue his own bank. "My timidity," he admits, led to many of the problems. Once focused, he managed a turnaround in just over four years. By the time the next blast of competition hit the big banks, during the 1980s, he was long retired. One can only guess at what he made of the banking carve-ups of the 1990s. There is no mention in the book of what is now J.P. Morgan Chase.

You can often see David Rockefeller at 87, walking across Rockefeller Center for his early workout at a public gym. He's a solitary figure in suit and tie, gracious enough to nod if one notices him. As he says, it has been a full life.

BY ROBERT J. DOWLING

Dowling covered the Rockefeller empire from Washington, New York, and Europe.



DAVID ROCKEFELLER REFLECTS ON HIS LIFE AND THE ESTABLISHMENT THAT RAN THE WORLD

BIG

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The BusinessWeek Best-Seller List

HARDCOVER BUSINESS BOOKS			LAST MONTH	MONTHS ON LIST	PAPERBACK BUSINESS BOOKS			LAST MONTH	MONTHS ON LIST
1	GOOD TO GREAT Jim Collins (HarperBusiness • \$27.50) <i>How run-of-the-mill companies make the leap to excellence.</i>	1	12		1	FAST FOOD NATION Eric Schlosser (HarperCollins • \$13.95) <i>The bad news on burgers.</i>	1		
2	EXECUTION Larry Bossidy, Ram Charan (Crown Business • \$27.50) <i>Making strategies work.</i>	2	4		2	THE TIPPING POINT Malcolm Gladwell (Back Bay • \$14.95) <i>What turns an idea into a hot trend, by a New Yorker writer.</i>	2		
3	NOW, DISCOVER YOUR STRENGTHS Marcus Buckingham, Donald O. Clifton (Free Press • \$27) <i>How to bolster your true talents.</i>	8	21		3	RICH DAD'S RETIRE YOUNG RETIRE RICH Robert T. Kiyosaki, with Sharon L. Lechter (Warner • \$17.95) <i>Plan ahead.</i>	3		
4	THE LEADERSHIP CHALLENGE James M. Kouzes, Barry Z. Posner (Jossey-Bass • \$27.95) <i>The core concepts of leadership.</i>	—	1		4	WHAT COLOR IS YOUR PARACHUTE? Richard Nelson Bolles (Ten Speed • \$16.95) <i>The 2002 edition of the enduring job-search bible.</i>	7		
5	CONQUER THE CRASH Robert R. Prechter Jr. (Wiley • \$27.95) <i>A depression is on the way.</i>	7	4		5	THE E-MYTH REVISITED Michael E. Gerber (HarperBusiness • \$16) <i>A systems approach for small-business success.</i>	8		
6	GLOBALIZATION AND ITS DISCONTENTS Joseph E. Stiglitz (Norton • \$24.95) <i>The IMF has failed, says a Nobel laureate.</i>	4	3		6	THE GOAL Eliyahu M. Goldratt, Jeff Cox (North River • \$19.95) <i>How to eliminate bottlenecks.</i>	—		
7	WEALTH AND DEMOCRACY Kevin Phillips (Broadway • \$29.95) <i>How the rich get richer: politics.</i>	5	4		7	THE 9 STEPS TO FINANCIAL FREEDOM Suze Orman (Three Rivers • \$13.95) <i>Learn to save.</i>	6	2	
8	THE FALL OF ADVERTISING & THE RISE OF PR Al Ries, Laura Ries (HarperBusiness • \$24.95) <i>Publicity is the key to building a brand.</i>	—	1		8	THE RICHEST MAN IN BABYLON George S. Clason (Signet • \$6.99) <i>Save 10% of what you earn—then pay your bills.</i>	15		
9	THE HEART OF CHANGE John P. Kotter, Dan S. Cohen (Harvard Business School • \$20) <i>Tales of organizational transformation.</i>	15	3		9	HOW TO MAKE MONEY IN STOCKS William J. O'Neil (McGraw-Hill • \$12.95) <i>Picking winners, by the founder of Investor's Business Daily.</i>	5		
10	THE FIVE DYSFUNCTIONS OF A TEAM Patrick Lencioni (Jossey-Bass • \$22) <i>Overcoming behavior that obstructs teamwork.</i>	11	5		10	THE LEXUS AND THE OLIVE TREE Thomas L. Friedman (Anchor • \$15) <i>The brave new world of globalization.</i>	—	1	
11	TUXEDO PARK Jennet Conant (Simon & Schuster • \$26) <i>A tycoon's scientific contributions toward victory in World War II.</i>	6	2		11	OWN YOUR OWN CORPORATION Garrett Sutton, Esq. (Warner • \$17.95) <i>The legal ins and outs of establishing a company.</i>	14		
12	FISH! TALES Stephen C. Lundin, John Christensen, Harry Paul, with Philip Strand (Hyperion • \$19.95) <i>Reel in more of the "Fish! Philosophy."</i>	10	6		12	HOW TO MAKE MILLIONS IN REAL ESTATE IN 3 YEARS STARTING WITH NO CASH Tyler G. Hicks (Berkley • \$14) <i>Make way, Donald Trump!</i>	11		
13	CREATE YOUR OWN FUTURE Brian Tracy (Wiley • \$24.95) <i>Steps toward success.</i>	—	1		13	NICKEL AND DIMED Barbara Ehrenreich (Owl Books • \$13) <i>Life among the working poor.</i>	—		
14	WHALE DONE! Ken Blanchard, Thad Lacinak, Chuck Tompkins, Jim Ballard (Free Press • \$19.95) <i>Tips from Shamu's trainers.</i>	12	7		14	MANIAS, PANICS, AND CRASHES Charles P. Kindleberger (Wiley • \$19.95) <i>The classic account of irrational financial behavior, by a former MIT professor.</i>	9		
15	GEEKS AND GEEZERS Warren G. Bennis, Robert J. Thomas (Harvard Business School • \$26.95) <i>The common characteristics shared by leaders young and old.</i>	—	1		15	REAL ESTATE RICHES Dolf de Roos (Warner • \$17.95) <i>Why buildings make better investments than stocks.</i>	4	1	

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THE 7 HABITS OF HIGHLY EFFECTIVE PEOPLE Stephen R. Covey (Fireside • \$14)

GETTING TO YES Roger Fisher, William Ury, Bruce Patton (Penguin • \$14)

THE ONE MINUTE MANAGER Kenneth Blanchard, Spencer Johnson (Berkley • \$12.95)

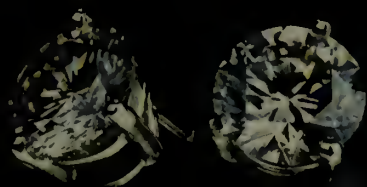
RICH DAD'S CASHFLOW QUADRANT Robert T. Kiyosaki, with Sharon L. Lechter (Warner • \$17.95)

RICH DAD'S GUIDE TO INVESTING Robert T. Kiyosaki, with Sharon L. Lechter (Warner • \$19.95)

THE MILLIONAIRE NEXT DOOR Thomas J. Stanley, William D. Danko (Pocket Books • \$7.99)

BusinessWeek's Best-Seller List is based on a survey of chain and independent booksellers that carry a broad selection of books on economics, management, sales and marketing, small business, investing, personal finance, and careers. Well over 1,000 retail outlets nationwide are represented. Current rankings are based on a weighted analysis of unit sales in September. Titles that have been on the Best-Seller List for more than two years appear as Long-Running Best-Sellers.

Reviews and more are available on AOL (Keyword: BW) or www.businessweek.com



LOVE IS
OUTPERFORMING
EVERYTHING
THIS YEAR



A DIAMOND IS FOREVER

BY STEPHEN H. WILDSTROM

tech&you@businessweek.com

HOW TO ACHIEVE DIGITAL NIRVANA



Downloaders and the entertainment industry will both have to bend a bit on copyright

How can we get to a world where online music, movies, and video are widely available, not just tentative experiments? This tantalizing vision is largely stalled, though not because of inadequate technology. Instead progress is held up by warfare among the entertainment, computer, and consumer-electronics industries with lawsuits and lobbying their weapons of choice. To get to the digital future that will benefit everyone, this has to end. But progress will require some important concessions on all sides.

Consumers, including the folks who've enjoyed free music from Napster and its successors, will have to realize that unless the owners of content get paid, there won't be any content. In the future, digital-rights management, a fancy term for copy protection, will limit what you can do with downloaded music and video—specifically, how many and what sort of copies you can make.

The entertainment industry, for its part, must realize that it cannot use new technology to take away rights that customers have long taken for granted, such as the ability to make copies for personal use. And the leading technology and consumer electronics companies, which have mostly sat on the sidelines afraid to offend either the entertainment industry or their customers, must play an active role in developing new standards. For starters, I think everyone should subscribe to some basic principles for a new digital world.

First, the right of fair use must be preserved. Consumers who buy music or videos should be able to watch or listen where they want, using the player of their choice. That includes the right to copy downloaded music into MP3 players or a TV show into SonicBLUE's upcoming Personal Video Player. But consumers must realize that fair-use rights are limited. For example, there is no right to give copies of copyrighted material away—Napster-style sharing is just plain wrong, as is making a copy of a CD for a friend.

Second, the entertainment industry has to realize that copy protection can never be perfect. As retailers know, a certain amount of pilferage is a cost of doing business. The trick is to keep the losses manageable. By demanding perfection, the entertainment industry is just throw-

ing up roadblocks to digital delivery. "Hollywood isn't willing to budge even an inch," complains Gregory Ballard, CEO of SonicBLUE, which is fighting a lawsuit in which TV studios claim its ReplayTV video recorders violate copyrights by letting consumers delete commercials and transfer recorded shows to other Replay machines.

Making digital-rights management work for everyone is a technical challenge. It is hard to develop a system that allows the downloading of content to different devices but limits the ability to create copies of songs or movies for others. But I'm sure that the smart people working on it can design an effective system.

The best way for this to happen is for everyone to support open standards, openly arrived at. The entertainment industry's attempts to develop proprietary schemes have been disasters. Both the Secure Digital Music Initiative and the Content Scrambling System for DVDs failed when the encryption schemes were quickly broken.

A big question is: Who can lead the effort to



develop a sensible approach to digital rights? Consumer-electronics companies have no history of cooperative standards efforts and a long tradition of format wars. Microsoft clearly wants to lead, but too many others fear the colossus of Redmond's real goal is to extend its Windows monopoly to rights management. The best candidate might be chipmaker Intel, which has taken a strong public stand against the entertainment industry's more extreme positions while working alongside it, particularly with AOL Time Warner, to develop hardware solutions.

In the end, both consumers and industry will have to give up something to get a lot. Consumers will lose some freedom to make copies, but will gain much richer online choices. Industry will give up some control and will have to accept some losses to piracy, but could gain vast new markets—as it did after the Supreme Court rejected its attempt to bar the sale of VCRs. It will take some time and a lot of goodwill, but the result could be a win-win outcome.

BusinessWeek online

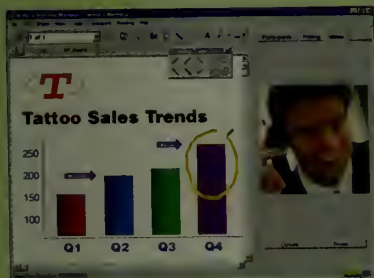
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Diversity at the Forefront: Visionary Leaders See Results



It has long been known that CEO involvement is a key driver of diversity success. But never before have more chief executives been personally involved in taking it to the next level. Today's top CEOs are going well beyond signing diversity mission statements, taking on closer management of how vision becomes action becomes profit. Increasingly, chief executives are the drivers of policy directives, the proponents of succession planning, the exponents of supplier diversity, the advocates for a new accountability that is associated with sales.

Why? Diversity has come of age. Thanks to the year 2000 census, the U.S. labor force data are in—and are incontestable. But the marketplace data are perhaps even more compelling: diversity purchasing power already tops an estimated \$5 trillion and is still growing at a much faster rate than U.S. buying power overall. Decades of diversity have produced myr-

iad examples of bottom line benefits through improved recruitment and retention and enriched teamwork in-house. Now leading CEOs are taking it farther outward, to the marketplace, where diversity promises to increase sales, market share and earnings growth through increased innovation and outreach to untapped or underserved markets. >>

Today's top CEOs realize that diversity is a pivot point in the big picture. They know their investment in making diversity happen is the right thing to do because, bottom line, it will pay off.

Getting Results: The New Accountability

CEO champions are insisting on measurement, accentuating accountability—but with a wider angle of vision.

In-house, the leaders are implementing strong linkages between diversity goals and financial rewards. As Marilyn Loden, co-author of the best-seller *Workforce America! Managing Employee Diversity as a Vital Resource*, explains, monetary mechanisms make workforce accountability stick. But, she adds, "they are most effective when an incentive for effort and effectiveness, a carrot rather than a stick."

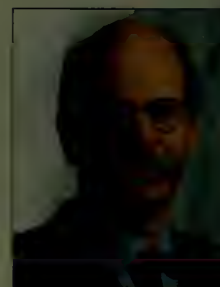
Today's CEO champions, notes Edie Fraser, President of Diversity Best Practices, Inc., "are personally monitoring diversity targets on a periodic basis." She finds many are revising performance metrics to make diversity management a core competency, and linking compensation directly to it. And leading CEOs "have this happening across the board," she says, insisting on diversity accountability from every department and from middle-management on up the corporate ladder.

Supplier diversity is another major area for achieving goals—and results. One recent report showed that a company with an active CEO almost always maintains a database of diversity suppliers and a written policy about hiring them. >>

"Creating an environment of inclusion for our associates, guests, and suppliers isn't just the right thing to do, it is the core of our business." — Barry Sternlicht, Chairman and CEO, Starwood Hotels & Resorts Worldwide, Inc.

Visionary CEOs: How They See It

"Differing opinions give our products a broader appeal, attracting a larger customer base," says Dieter Zetsche, President & CEO, DaimlerChrysler Corporation. "The broader the scope in perspectives," he continues, "the broader the scope of success." Toward that end, Zetsche has just signed a new Diversity Statement. He regularly addresses Employee Resource Groups (diversity networking groups) within the company, and he strongly supports the automaker's Diversity Committee. The Committee consists primarily of officers who meet monthly to discuss diversity-related strategies and reports to the Executive Committee quarterly on its progress. "It is evident from the positive turnaround the company is making today," concludes Zetsche, "that our diversity has been critical to achieving our short-term goals and will be essential to ensuring our long-term profitability."



Dieter Zetsche, President & CEO, DaimlerChrysler Corporation



Dennis Nally, Chairman and CEO, PricewaterhouseCoopers, LLP.

"We must promote diversity and inclusion to attract and retain the best talent, to maintain meaningful client relationships, to win continuously in the marketplace," says Dennis Nally, Chairman and CEO, PricewaterhouseCoopers, LLP. Toward that end, the firm maintains an aggressive campus recruitment campaign, a strong investment in professional development, and 'Minority Circles' and 'Mentoring Partnerships'—which prepare women and minorities for partnership. (By 2005, they expect women to comprise at least 30 percent of new partners.) "And our leadership will be held accountable," Nally notes, "through performance metrics linked to financial rewards."

Diversity is all about economic investment, market outreach, business results," says Rick Priory, Chairman, President and CEO, Duke Energy. "The creative mind power of our team is Duke Energy's greatest competitive advantage," he explains, "and we increase the advantage every time we expand our thinking." Diversity is not a lofty ideal or philanthropic undertaking. Changing times call for a dynamic, diverse, multi-disciplined workforce that embraces change, new ideas and collaborative problem-solving. That is the culture they continually instill at Duke Energy. Why? Because "we see diversity and inclusion as an absolute bottom-line issue and business imperative."



Rick Priory, Chairman, President and CEO, Duke Energy

Coming of Age: 50 years of Diversity Milestones

>>1954 — Brown v. Board of Education makes racial segregation illegal in education	establishes equal pay for equal work	>>1964 — Civil Rights Act prohibits job discrimination based on sex, religion or nationality	>>1965 — Five-member Equal Opportunity Employment Commission (EEOC) formed	>>1967 — New York Stock Exchange sees Muriel Siebert become first woman to own a seat >>1971 — Supreme Court rules
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Still, diverse suppliers get less than 3% of all corporate purchasing dollars today.

CEO champions are pushing hard to raise that number. Diversity Best Practices reports that many of the leaders are overseeing significant spending increases with diverse suppliers. One reason? They want diversity to become a sales tool, and diverse suppliers can help companies penetrate untapped or underserved markets.

That rationale is suggestive of the new thinking on accountability. At the fore-

U.S. Diversity* Buying Power Today

Women	3.7 trillion
Disabled Americans	1 trillion
Hispanic Americans	550 billion
African Americans	500 billion
Gay Men and Lesbians	450 billion
Asian Americans	253.8 billion
Native Americans	34.8 billion

*excludes senior citizens, as not all sources characterize them as a diversity market

Sources: Women and Diversity WOWfacts, 2002; National Organization on Disability; EmployAbility; Santiago & Valdes Solutions; Selig Center for Economic Growth at the University of Georgia; Datamonite; U.S. Pan Asian American Chamber of Commerce; DiversityInc.com.

front, CEOs are moving beyond diversity as a workforce issue and also seeking to realize its promise for increased sales. The leaders are moving to count the ways diversity can add up to stronger performance in the marketplace. >>

Coming of Age: 50 years of Diversity Milestones

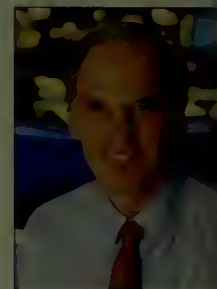
customer preferences cannot justify discriminatory hiring in Diaz v. Pan Am >> 1972 — Title IX bars sex discrimination	in publicly-funded education >> 1974 — Equal Credit Opportunity Act states credit cannot be refused based on sex	or marital status >> 1980s — “Valuing Diversity” movement takes shape >> 1987 — Workforce 2000 projects	only 15% of new workers will be native-born white men >> 1990s — Business case transforms “Valuing Diversity” to
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“Our diversity has been critical to achieving our short-term goal and will be essential to ensuring our long-term profitability.”

— Dieter Zetsche, President & CEO, DaimlerChrysler Corporation

Visionary CEOs: How They See It

“The accountability for diversity starts with me,” says Bill Harrison, CEO, JPMorganChase. “That’s why I head our firm-wide Diversity Council.” All senior managers are accountable, in turn, for managing to a formal diversity plan and for linking diversity to education, recruiting, succession planning, career development and business growth. Each of the company’s businesses sponsors its own council, which ensures hands-on employee involvement in diversity initiatives. The company has also instituted flextime and job-sharing, a range of career development programs, an aggressive expansion of onsite back-up day care across the US—all to garner the broad range of employee talent and perspective. “By continuing to involve employees at levels and in all locations,” concludes Harrison, “we will continue capitalizing on internal and external opportunities that come from an inclusive, diverse organization.”



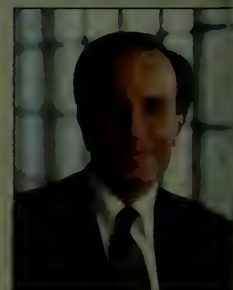
Bill Harrison, CEO, JPMorganChase



Anne Mulcahy, Chairman and CEO, Xerox Corporation

“How do corporations build, celebrate and nurture diversity?” According to Anne Mulcahy, Xerox Corporation’s Chairman and CEO, you earn it. You stick to it. Most important, you treat it not as something ‘nice to do’ but as a business imperative. Xerox senior managers are regularly evaluated on ‘balanced workforce’ objectives. When forced to downsize, managers insist that reductions mirror current workforce representation. Externally, Xerox values a diverse customer base, reflected in its Women’s Business Owner Initiative. “Recognizing the growth of women’s entrepreneurship, Xerox is providing resources and support to help women-owned businesses flourish.”

“It’s my responsibility is to establish values, set the cultural tone and keep diversity in front of employees,” says Ivan G. Seidenberg, CEO, Verizon Communications. So, he created the Office of Diversity and Business Compliance. Today, twenty-three diversity councils oversee business-unit specific strategies on leadership development, mentoring, and diversity training. Senior leaders are accountable through incentive compensation. And Verizon spends over \$1.5 billion with diverse firms, including four recently added to the 15 minority-owned companies managing its pension fund. “When diversity becomes part of a company’s culture, everyone benefits—employees, suppliers, and customers.”



Ivan G. Seidenberg, CEO, Verizon Communications

Start Here. Go Anywhere.

Creating an environment of inclusion
for our associates, guests and suppliers
isn't just the right thing to do,
it's our business.

Starwood Hotels & Resorts employs
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The Survey: "The Best of the Best: Corporate Awards for Diversity and Woman"

This is the second year that Diversity Best Practices (DBP) and Business Women's Network (BWN) have released a special report tallying results from over three dozen "best company" lists produced in the past two years. The report highlights those companies that excelled at the diversity criteria established by the lists. This year, what DBP uncovered was a passionate commitment from the top, and an understanding of the impact on recruitment and retention; customers and markets; suppliers and stakeholders; stock price; company reputation. ♦

Commitment from the top includes:

- ♦ Signing diversity mission statements
- ♦ Insuring top management support
- ♦ Chairing diversity council
- ♦ Reviewing diversity reports on periodic basis
- ♦ Endorsing diversity within bonus system
- ♦ Supporting supplier diversity goal attainment
- ♦ Championing diversity in succession planning
- ♦ Supporting mentorship
- ♦ Giving Diversity Speeches
- ♦ Attending internal and external diversity events
- ♦ Endorsing diversity sponsorships
- ♦ Supporting diversity advertising

Seeing the Difference: Leaders Eye the Marketplace

The diversity of American consumers makes it critical to develop marketing strategies for specific target segments. Today's leaders are investigating >>

"Diversity is the defining characteristic of what it means to work and do business with JPMorganChase." — Bill Harrison, CEO

Visionary CEOs: How They See It

"Starwood is built on diversity," says Barry Sternlicht, Chairman and CEO. "With six distinct brands—Westin, Sheraton, Four Points by Sheraton, St. Regis, The Luxury Collection and W Hotels—operating in over 80 countries, our associate and customer base is as diverse as the world's population." As an organization, they're committed to setting the pace for the industry, raising the bar on how they deploy and develop associates—especially the 53% of current associates who are people of color—and, in the process, understanding how diversity yields business success. In just their fifth year as a company, they have established a Diversity Council of senior leaders. Sternlicht emphasizes, "We are serious about making diversity an unconscious part of how we do business everyday, everywhere, for everyone."



Barry Sternlicht, Chairman and Chief Executive Officer, Starwood Hotels & Resorts Worldwide



Daniel Carp, CEO, Eastman Kodak

"We're a diverse company from our employees, to our supplier base, to the markets we serve," says Daniel Carp, CEO, Eastman Kodak. Two years ago, Kodak created a Global Diversity Office; last year, a voluntary, external Diversity Advisory Panel, comprised of business, government and academic leaders; and this year, the position of Director, Multicultural Marketing. These efforts are expected to result in even more diversity within the company's 75,000 employees, and greater growth in diverse markets. "Success today demands the best ideas from the broadest spectrum of people, working together," Carp says.

"We would not be able to grow our business globally if we didn't open ourselves up to the perspectives of others," says Douglas N. Daft, Chairman and CEO, The Coca-Cola Company. This perspective extends outward, from company to markets to society. Coca-Cola has launched an \$800 million investment to increase minority and women-owned supplier spending within five years, and a Diversity Leadership Academy to build diversity management skills in government, non-profit, education and business. "When we connect with consumers locally," says Daft, "our brands become significantly stronger and our business has flourished."



Douglas N. Daft, Chairman and CEO, The Coca-Cola Company

Coming of Age: 50 years of Diversity Milestones

"Leveraging Diversity" >>	individuals with disabilities	leave for family reasons >>	>> 1999 — Women-owned
1992 — Americans with Disabilities Act (ADA) prohibits discrimination of qualified	>> 1993 — Family and Medical Leave Act (FMLA) guarantees up to 12 weeks unpaid	1997 — Black-owned businesses increase 26% during previous five years, says Census.	businesses increase 10% during previous 15 years, reports National Foundation

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how women and ethnic consumers differ in purchasing behavior.

For example:

- ◆ Hispanics are more brand-loyal than other consumers, with a majority believing brand names are superior to store brands. (Hispanic-Market.com)
- ◆ African American women are the primary decision-makers for housing and related purchases, financial services, mortgages, and investment products. (DiversityInc.com)
- ◆ Almost all (94%) gay men and lesbians would go out of their way to purchase products and services marketed directly to them. (Greenfield Research & Kinsey Report)
- ◆ People with disabilities are highly motivated to spend money in quality of life areas such as travel, entertainment, education, clothing, computers, exercise equipment, sports gear, transportation and house cleaning services. (National Organization on Disability; EmployAbility)

Appreciating customer differences in buying habits and understanding how to build brand loyalty is the next step for companies ready to grasp what diversity means for their business. ♦

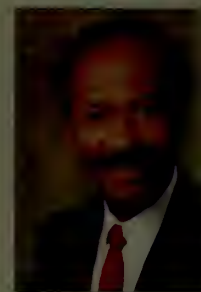
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"Fannie Mae offers proof that making diversity part of your corporate values can be a powerful business strategy." — Frank Raines, CEO, Fannie Mae

Visionary CEOs: How They See It

"Fannie Mae's success comes from being a values-driven company," says Frank Raines, CEO. "And one of our most productive values is our diversity." Their Office of Diversity was established ten years ago to develop explicit policies to recruit and retain minorities and women at all levels. Its officers have long been compensated based on meeting diversity targets. And its Vice President of Diversity reports directly to the Vice Chairman and COO. Today, minorities and women make up half its 18 Board members; 57 percent of its officers and directors; 69 percent of new hires; and 70 percent of the company overall. "We also believe in sharing our knowledge," Raines says, "by holding regular benchmarking sessions with other companies and providing diversity training to lender partners."



Frank Raines, CEO, Fannie Mae



Ralph Shrader, Chairman and CEO, Booz Allen Hamilton

"Our people strategy is built on 10 core values," explains Ralph Shrader, Chairman and CEO, Booz Allen Hamilton. Five are individual—professionalism, fairness, integrity, respect, and trust; and five are institutional—client service, diversity, excellence, entrepreneurship, and teamwork. On this foundation, they've achieved a pluralistic culture, record number of people of color in the senior ranks, and leadership in the advancement of people with disabilities. "There is a major difference between supporting diversity and playing an active role in fostering it," Shrader says. "We must not only think differently, we must do differently."

"As one of the largest family-owned businesses in the country," says Marilyn Carlson Nelson, Chairman and CEO, Carlson Companies, "we're committed to advancing talented women, strengthening families and casting a wide net of inclusiveness." On-site child care, flexible scheduling, and other family-friendly benefits have sure made an impact: over 30% of vice presidents and above are women. "Our diversity philosophy is described by a slightly adapted poem," says Nelson. "He drew a circle and left me out. But Love and I had the will to win: We drew a bigger circle...and drew him in!"



Marilyn Carlson Nelson, Chairman and CEO, Carlson Companies

Coming of Age: 50 years of Diversity Milestones

for Women Business Owners	Fortune 500 companies have	decade, reports Selig Center	Media Matrix >> 2002
>> 2000 — U.S. Census	women CEOs >> 2001 —	>> 2002 — On-line con-	Diversity marketplace excee
counts gay men and lesbians	Hispanic buying power increas-	sumers mirroring population	\$5 trillion, according to Divi
for first time >> 2001 — Six	es 118% during previous	demographics, finds Jupiter	sity Best Practices tally.

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— *Working Mother*, 1998, 1999, 2000, 2001

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OPPORTUNITY

BY ROBERT J. BARRO

BUSH'S ECONOMIC POLICIES: THE BULL'S-EYES AND BUSTS



MIXED BAG:
The tax cut
is a huge
success,
trade policy
a flop. Now,
deflation
looms, and
antitrust law
should be
rewritten or
scrapped

Robert J. Barro is a professor of economics at Harvard University and a senior fellow of the Hoover Institution (rjbweek@harvard.edu).

The Bush Administration's economic policy continues to be a mixed bag. Some policies work, others don't.

The biggest policy win, of course, is the tax cut of 2001, which continues to be a positive for the U.S. economy. It would have been better if the tax-rate reductions came into effect earlier, and if tax changes had been made to favor more business investment. Movement in these areas seems unlikely as long as the Democrats control the U.S. Senate. That might change come the November elections.

The worst policy moves so far have been in international trade (notably in steel, agriculture, and timber) and fiscal discipline (in education and health). The Administration seems also to be allowing the inquiries into corporate fraud to turn into witch hunts that will harm enterprise for a long time. Of course, the worst example is the reckless legal assault on the financial sector by New York Attorney General Eliot Spitzer. But I confess to amusement over Spitzer's attacks on the quality of stock-picking, such as Salomon Smith Barney's Jack Grubman maintaining for too long, at least publicly, a positive outlook on WorldCom Inc. Economists tend to think that the value of these kinds of stock recommendations—whether, for example, to go long or short on WorldCom when its stock price reached \$3 or \$1—is about zero.

Another concern is monetary policy. Throughout the Volcker-Greenspan era, the Federal Reserve has cut interest rates when inflation remained low and when the economy was weak, gauged especially by slow employment growth. This policy led to the extremely low federal funds rate—1.75%—that prevails today, leaving little room for stimulus through further rate cuts. At some point, monetary policy may have to shift from a concern with inflation to the avoidance of the kind of deflation that prevails in Japan. In particular, if short-term rates get close to zero and the general price level starts to fall, then the monetary stance cannot be judged as stimulative. Rather, low interest rates would just be a symptom of expected deflation, and the way to stimulate the economy would be to create positive inflation by printing money at a faster rate. In this environment, successful stimulus shows up as higher interest rates along with higher inflation. Japan is already in this situation, but the U.S. is not yet there. One hopes the Fed is prepared to cope with deflation, should it arrive.

I applaud the intervention into the strike-lockout of the West Coast ports, although earlier

action would have been better for the economy. The International Longshore & Warehouse Union (ILWU), with membership of just over 10,000 semi-skilled workers, has used its muscle in the past to boost annual wages to over \$100,000. Their current priority is to stifle the introduction of productivity-enhancing technology, which would likely compromise the monopoly position of the union. Despite the egregious use of monopoly power to hamper international trade and stifle productivity, the Administration was wary of intervening, apparently fearful of the upcoming November elections and the political costs of moving against organized labor. My guess is that the Administration would do better to look at Ronald Reagan's actions in the early 1980s against a similarly intransigent union, the air-traffic controllers. It turned out to be widely popular and was probably Reagan's finest hour.

Another problem with the Bush Administration's economic policy is that it isn't using antitrust laws properly. They aren't working for either labor or capital. With labor, they function to promote monopoly. If the U.S. had sensible antitrust laws, the actions of the ILWU would violate them. The original Sherman Anti-Trust Act of 1890 forbade any action that was a "conspiracy in restraint of trade or commerce among the several States or with foreign nations." In fact, the Sherman Act was used extensively against labor unions in the 1890s. But later legislation (notably the Clayton Act of 1914 and the Wagner Act of 1935) effectively exempted labor unions from antitrust laws. It would be nice to see the Administration propose a new law to treat business and labor in a balanced way. After all, monopoly over labor in a sector can have adverse economic effects.

So can overcapacity. When it comes to capital, the applications of the antitrust laws seem to prevent consolidation when it is most needed. In the telecom sector, the Justice Dept. (along with the European Union) thwarted the merger in 2000 between MCI and Sprint Corp. Now, it is hard to find an industry with more overcapacity and where consolidation would make more economic sense. Similarly, the U.S. government has prevented mergers of airlines, such as United Air Lines Inc. and TWA Airways Inc., despite overcapacity. More recently, the government impeded a merger of two satellite television companies—EchoStar Communications Corp. and DirecTV—although such a merger would likely enhance competition in the broader market for television signals. If we cannot get a better system, we might be better off repealing all antitrust laws.

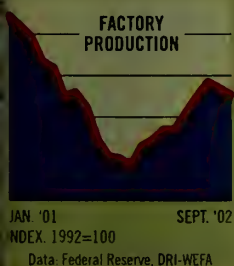
JAMES C. COOPER & KATHLEEN MADIGAN

THE HOT-AND-COLD RECOVERY COULD WARM UP SOON

After a slow fourth quarter, the economy should gain momentum in 2003

U.S. ECONOMY When stock prices plunged 28% from mid-May to late July, the fear was that the stock market would derail the recovery because consumers would stop spending if businesses wouldn't make any money. Those fears proved to push stocks even lower by early October. But a funny thing happened on the way to economic collapse: Consumers kept buying cars and homes, and many companies showed good gains in third-quarter profits. More fundamentally, the economy continued to enjoy some benefits that have been constants over the past year or more. Namely, robust productivity growth helped to lift both real household incomes and profit margins, and monetary policy remained quite accommodative. Consequently, when the Commerce Dept. reports the quarter's growth in real gross domestic product on Oct. 31, the numbers are likely to show a solid advance, probably in the 3%-to-4% range.

SOME BACKTRACKING IN MANUFACTURING



To be sure, the economy didn't weather the market's summer slump totally unscathed. Companies, especially those in manufacturing, appear to have taken a breather in late summer (chart). Industrial output fell in August and September, and many companies showed new hesitancy to lay in inventories or expand payrolls. In addition, consumers were less optimistic about the economy by the quarter's end than they were in July. As a result, the economy began the third quarter strongly, but finished at a weaker pace. That sets up the difficult math for fourth-quarter GDP growth, since many sectors started this quarter at levels that are lower than their third-quarter averages. So the fourth-quarter GDP data will likely look disappointing.

BEFORE INVESTORS, consumers, and executives resurrect their double-dip recession fears, they should remember that the monthly pattern of activity in this quarter will set the stage for 2003 growth. For instance, the wave of refinancing applications through mid-October means extra cash will be flowing to many homeowners throughout all of the fourth quarter. Plus, inventories probably ended the third quarter at a record low relative to sales. And since demand, espe-

cially by consumers, shows no sign of petering out, skimpy inventories will spur industrial orders and output. Add in the constant pluses of good productivity gains and low interest rates, and it is easy to see how the economy will end the fourth quarter on a stronger note, a positive trend for growth in early 2003.

Of course, the economy will still need to get through this quarter, and the news now is not all good. For instance, the Conference Board's index of leading indicators, designed to foreshadow economic trends, fell 0.2% in September, the fourth decline in a row. However, stock prices and two other related indicators accounted for most of the index' weakness since May. So the forecasting accuracy of the index in coming months will depend largely on how good the stock market is at predicting economic growth—and historically, its record has been spotty.

IMPORTS SPEED UP AS EXPORTS LAG BEHIND



A BIGGER CONCERN for the fourth-quarter outlook is the increase in business caution. The summer's new uncertainties, especially about future demand trends, fell back most notably on manufacturers. Overall industrial production fell in September for the second month in a row, as did output in the factory sector alone, down 0.2% and 0.3% in August and September, respectively. Those declines followed solid growth over the previous seven months, and industrial surveys suggest that output dipped again in October.

The September industrial weakness was especially evident in business equipment. Production in this crucial sector had turned up from May to August after a long period of decline. Then, September equipment output dropped 1.7%, a sign that some businesses put their capital spending plans on hold this summer.

Some of those spending plans may now be moving forward again, given that the stock market has rallied and appears to be holding on to its gains amid many upbeat third-quarter profits reports (page 48).

Businesses should also begin to look more favorably on the future, as long as consumers keep spending. Consumers may say the market slump has rattled them, but they continue to have enough faith in the future to commit a sizable amount of future income to the

Business Outlook

purchase of a home. Record sales of new homes in August fueled a 13.3% surge in housing starts in September. The monthly increase was the largest in seven years and boosted housing starts to the highest level since 1986. Plus, increases in home buying always lift consumer spending for home-related goods.

With consumers still willing and able to buy, some businesses that were overly cautious in recent months may get caught short of merchandise in coming months. The August ratio of overall business inventories to sales was far below its long-run trend, suggesting that stockpiles are already too low. If retailers' dire concerns about the holiday shopping season turn out to be exaggerated, the need to build up inventories will set the manufacturing recovery back on track.

AN ONGOING PROBLEM for U.S. manufacturers, however, will be that a lot of that inventory rebuilding will come from foreign factories (chart, page 41). That was clear from the government's August report on foreign trade, which showed a huge widening in the trade deficit, from \$35.1 billion in July to \$38.5 billion in August. Imports jumped 2% from July, and so far this year, they are growing at an annual rate of 23.1%.

But companies that export may also feel some pressure in coming months. Exports plummeted 1.3% in August, and growing weakness in the euro zone will be a factor limiting growth this winter, particularly against

the backdrop of continued strength in the dollar.

Manufacturers are also getting hit by a lack of pricing power, thanks to global competition and excess production capacity. Over the past year, consumer inflation has been running at 1.5%, with core inflation, including energy and food, at 2.2%. However, those numbers mask sharply divergent trends in goods and services (chart). Core service prices in September were up 3.6% from a year ago; core goods prices fell 1.1%.

Factory capacity utilization stood at 74.2% in September, well below its long-run average of about 81%, and import prices were still down from a year ago. With that in mind, it's little wonder why goods producers are so skittish, since their returns on investments in new equipment, inventories, and workers depend heavily on the revenues their goods generate.

However, businesses' worst fears from this past summer—that demand and the economy were falling off a cliff—have not materialized. A key feature of this recovery has been its jumpy growth pattern. And once the economy gets through the current soft period, the up-and-down recovery will head up again.

INFLATION: A TALE OF TWO SECTORS



EURO ZONE

WILL THE CENTRAL BANK GIVE GERMANY A BREAK?

The European Central Bank is in a quandary. Growth in the euro zone is weak and fading, but areawide inflation remains above the ECB's 2% limit. So pressure is growing from both Germany and France to cut interest rates now.

After posting a 1.5% annual rate of growth in the first half, the euro zone economy struggled to match that pace in the third quarter. Plus, industrial data through September showed a steep loss of momentum over

the third quarter, meaning that fourth-quarter growth will be slower still. The German economy could even contract this quarter.

At the same time, the ECB is caught between German and

French fiscal policies. The deficits of both countries are excessive by euro zone standards, but the ECB cannot make policy favorable to Germany, which is attempting to limit its budget overruns, since a rate cut would also benefit France, which is openly refusing to tighten its budget.

For now, the ECB seems in no hurry to ease policy. It held rates steady at 3.25% on Oct. 10, citing balanced risks to price stability. The rate has been unchanged for

nearly a year. Still, the ECB's *Monthly Bulletin* sounded slightly less hawkish. The bank emphasized the risks to growth from the plunge in stock prices, and while September inflation remained at

2.1%, the bank noted inflation expectations have been falling this year. That's because businesses say pricing power is nil. And with growth expected to continue below the euro zone's 2%-to-2.5% potential growth rate well into 2003, inflation should fall, barring another spike in oil prices.

The main risk is an economic slump, not inflation. Businesses have pulled back amid heightened uncertainty after the drop in stock prices, and they are hesitant to build inventories. And with domestic demand still weak, the falloff in global demand is further hurting orders and industrial output. This scenario is hitting Germany especially hard. Indeed, the ECB's policy choice may well come down to sacrificing Germany to recession in order to assure price stability across the region.

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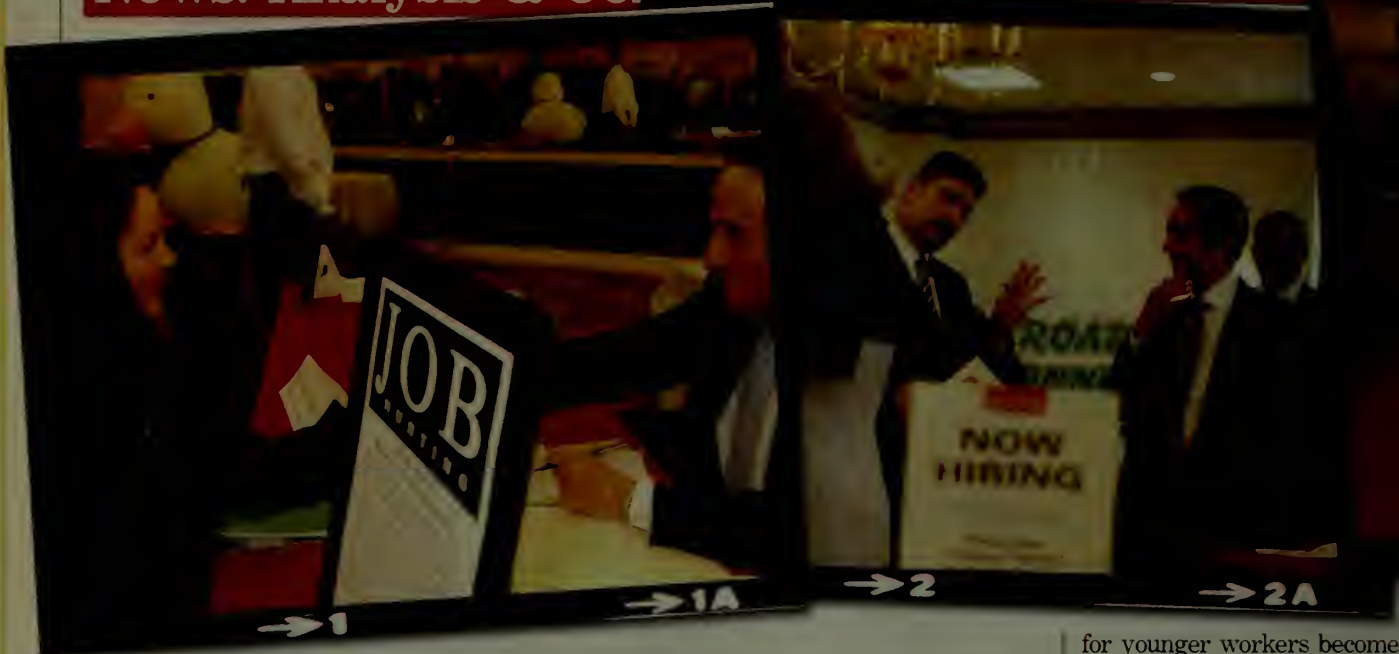
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A LOST GENERATION?

Young and mid-career job seekers are bearing the brunt of U.S. layoffs

A year and a half ago, Malene Comes of San Jose, Calif., and her husband, Craig, were raking in \$120,000 a year and living *la dolce vita*. The two San Jose computer technicians indulged in lavish trips, hired a cleaning lady, and ate out almost every night. Then, both were laid off. Today, they get bags of groceries from a San Jose food bank, have joined the ranks of the uninsured, and beg their parents for \$1,045 in rent for their 600-square-foot apartment. "We didn't think we could fall this low," says Malene, 30, who has a low-paying job helping mentally retarded adults. Craig, 36, works part-time at specialty retailer Brookstone Co. and as a substitute teacher. Together they make about \$35,000 a year. Says Malene: "The fun days are over. Let's face that."

Economists may say the 2001 recession is over, but it doesn't look that way to unemployed and underemployed people like Malene and Craig Comes. During the boom years, they looked set to inherit the earth. The best and brightest earned fat signing bonuses, big salaries, and fancy perks. With their futures seemingly secure, many young and mid-career workers took on big debts as they splurged on expensive houses, cars, and vacations.

Now, many of them feel like a lost generation, worried that their peak earning years are behind them even as their expenses jump. For the youngest, the costs of raising families and paying mortgages lie ahead. For those closer to middle age, the burdens are heavier. "These guys are despondent," says psychologist Alden Cass, managing director at New York's Catalyst Strategies Group who studies laid-off brokers. He knows ex-Wall Streeters who are tending bar, waiting tables, or working at the likes of RadioShack and the Gap.

In a reversal of the late 1990s, young workers are being jettisoned right and left as companies make more room for older people many previously thought of as corporate has-beens. As opportunities

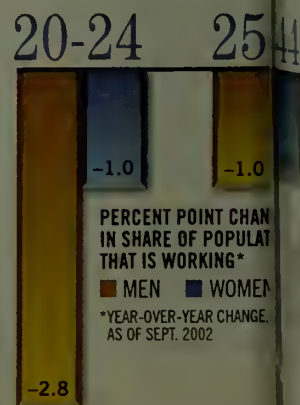
for younger workers become more scarce, their elders are staying on or returning to work, often desperate to rebuild diminished retirement savings.

Traditional unemployment measures don't capture the challenge for young and mid-career workers, who are flocking to national job fairs in an often futile search for work. They don't include people who have become discouraged and dropped out of the labor force. A better statistic is the share of the population in a given age group that has a job, for which even a small drop is meaningful.

So how are different cohorts doing that measure? At the height of the boom in early 2000, 88% of all men in the U.S. from the ages of 20 to 44, excluding those in the military, jail, and other institutions, had jobs. By September, 2002, only 84.8% had jobs. For women 20 to 44, the employed share fell from a peak of 73.9% in early 2000 to 70.6% in September, 2002. Although women aged 45 to 54 fared slightly better—73.5% of them remain employed, a small drop from 73.9%—their male counterparts were hard hit: 84.8% of them had jobs, down from 85.9% a year earlier. Surprisingly, older workers are the only ones who have done well. The

THE AGE GAP IN JOBS

The proportion of Americans aged 55 and over who are working has grown





UPSIDE DOWN

Young people are flocking to job fairs like this one in Edison, N.J., on Oct. 22. Meanwhile, ravaged retirement portfolios have forced more older workers back into the job market—and employers are hiring more of them

... of men 55 to 64 with jobs, rose from 64.2% to 67.2% over the past year, and the share of women 55 to 64 with jobs rose from 51.7% to 54.4%.

Things are likely to get worse in the months ahead as companies cut jobs to restore profitability (page 106). Sluggish economic growth is the root of the problem. "We're looking for the continuation of a grudging, difficult, gradual recovery with a not-insignificant possibility of a double dip" into recession, says Michael Andrews, chief U.S. economist for Standard & Poor's Global Financial Markets.

The bloodbath on Wall Street is a warning, if extreme, case of the plight of young and mid-career workers. Job cuts at brokerages since the bear market began are even deeper than after the 1987 stock market crash. All told, an estimated 10% of jobs that existed at the industry's 1999 peak will have been eliminated by the end of 2002. It will likely be years before many of those jobs return, leaving people who've been laid off with little prospect of working again in their field. And even when those jobs do return, they'll be filled with new strivers, says veteran Wall Street pay consultant Alan John-

son. Brokerages hire scads of young people, only a few of whom ever reach the top. "The people above 45 are more likely to be senior management—and they are the ones making the layoffs," says Guy Moszkowski, a financial-services analyst at Salomon Smith Barney.

But Wall Street is hardly the only street in America filled with the abruptly jobless. Many younger people flocked to technology and telecom companies that have been devastated by the capital-spending slump. The once-mushrooming info-tech business will add virtually no jobs this year, according to the Information Technology Assn. of America.

Why are young and mid-career workers bearing the brunt of the cutbacks? One reason is that many got bigger raises than old-timers during the boom, so they're no longer much cheaper to employ. At the same time, they often lack the deep institutional knowledge and personal ties with clients and customers that are especially valuable in tough times. Says Michael Recca, president of Sky Capital LLC, a startup brokerage firm: "Everybody in this market prefers a veteran."

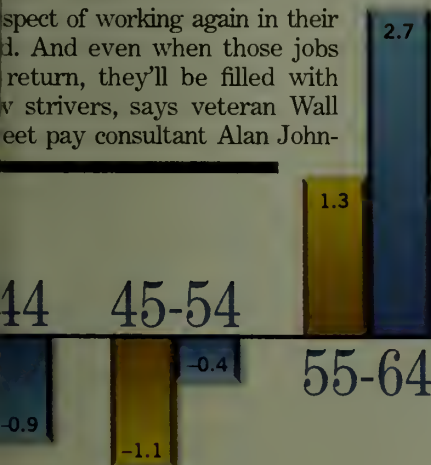
The 20-to-44 group has other woes to

contend with, too. Age-discrimination rules, by shielding older workers, may end up disproportionately exposing younger ones to layoffs. Young people have been whacked by layoffs in unionized businesses such as heavy manufacturing, airlines, and phone companies, where the least senior are often the first to go. Even global outsourcing may play a role. Gartner Inc. researcher Frances Karamouzis says a New York company that recently laid off 500 people is retaining its generally older software system designers while dumping its younger coders and programmers. Says Karamouzis: "The work is going off to India, where they get much better value."

Many laid-off workers, realizing that the jobs they lost may never return, are striking out in new directions. Dan Arol Jahns, 32, who lost his six-figure job at Goldman, Sachs & Co. in August, 2001, chased a lifelong dream of becoming an actor. He first found work playing a chess piece at a Toys 'R' Us Inc. store opening. Since then, he has landed roles on stage and TV. Most, though, are more prosaic. A record 31,000 people took the Foreign Service exam this year, more than double last year's total. The number of those taking the law-school placement test is up 17% this year, and BusinessWeek school applications for this fall's class were up 25% to 30%.

Applicants had better hope conditions improve by the time they get out: Only 70% of the graduates of BusinessWeek's top 30 business schools landed jobs by graduation last spring—a lower percentage than during the last recession. "We expect [2003] is going to be another tough year," says Kim B. Clark, dean of Harvard Business School, where nearly 20% of 2002 grads had still not found work by graduation.

Only workers nearing retirement age are faring well: A greater percentage of those over 55 are working today than a year ago. In part, that's because older



WHERE JOBS ARE DRYING UP

Change in employment, September, 2000, to September, 2002

TEMPORARY WORK	-18.4%
COMPUTERS & OFFICE EQUIPMENT	-18.1
PRINTING & PUBLISHING	-9.4
AUTOS	-8.7
FINANCIAL SERVICES	-7.3

Data: Labor Dept., DRI-WEFA

workers are prized for their experience and stability: "It's not at all surprising that we're seeing people who have come from an Old Economy set of values becoming more attractive again now," says Barry Honig, president of New Jersey-based executive-search firm Honig International. Companies such as AMR Corp., parent of American Airlines, are trying to retain older workers as they cut jobs because of the brain drain they suffered in the past from offering early-retirement incentives. They also want to avoid the

high upfront costs of employee buyouts.

But for the silver-haired generation, rising employment is not entirely by choice. Many are staying on the job or reentering the workforce because they need the money: The bear market has smashed their nest eggs. Shel Hart, a vice-president at staffing firm Spherion Corp., says 40% of executives aged 55 and older who are applying for jobs now are doing so because of damage to their retirement portfolios. James Alexander, 55, retired from Westinghouse in April,

2001, but a year later, after losing big stocks, moved from Pensacola, Fla., Sandusky, Ohio, to take a job as a plant manager at a consumer-products company—at a 30% cut in compensation.

Young people who can't find jobs and older people who can't afford to quit. All in all, it's not a pretty picture. But until the economy revs up it's a fact of working life.

By Peter Coy, Michelle Conlin, and Emily Thornton in New York, with bureau reports

COMMENTARY

By Catherine Arnst

WOMEN WORK. THE SUPPORT SYSTEM DOESN'T

In the late 1990s, single women were all the rage. *Sex and the City*, the HBO series about four bachelorettes in Manhattan, became a favorite water cooler topic, while the best-seller lists featured the blockbuster novel—and hit movie—*Bridget Jones's Diary*, about the misadventures of a London "singleton."

But time marches on, even for singletons. This season *Sex and the City*'s Miranda (the lawyer played by Cynthia Nixon) has a baby, as does Rachel (Jennifer Aniston), one of NBC's *Friends*. ABC has a hit on its hands in *Life with Bonnie*, a sitcom starring Bonnie Hunt as a harried talk show host with three kids. And the best-seller lists feature two books focused on... you guessed it, working mothers.

On the nonfiction side, there's *The Bitch in the House*, a collection of essays by 26 women about the travails of balancing work, love, and family. Climbing the fiction list is *I Don't Know How She Does It: The Life of Kate Reddy, Working Mother* by Allison

Pearson. Think of it as *Bridget Jones Gets Married*.

Why, suddenly, are working moms hot? "Common sense tells you that there is an audience out there," says Lloyd Braun, chairman of ABC Entertainment's television group. *Life with Bonnie* "really celebrates being a working mother."

Could it be that America is finally ready to lift the guilt from the shoulders of the working mom? After all, the vast majority of

mothers do work—72% of them in 2001, according to the Census Bureau. And though it may be politically incorrect to say so, many of these women actually like working. A survey by the non-profit research group Catalyst reveals that 67% of women in dual-career marriages would continue working whether or not they needed the money.

Hollywood, though, has yet to reflect the fact that while working mothers are the norm, the

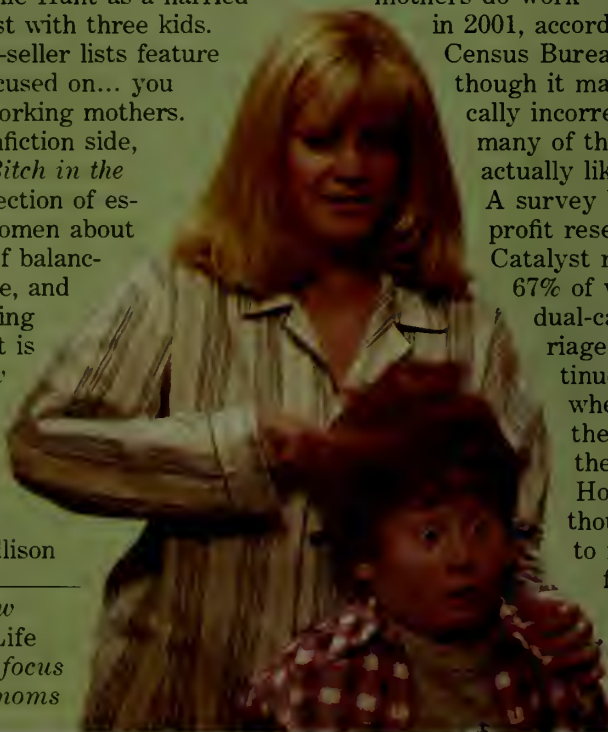
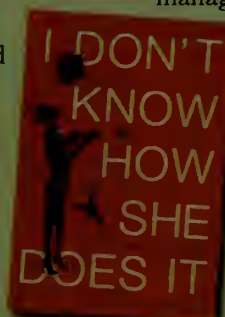
infrastructure to support them is sorely lacking: affordable, high-quality child care, husbands who assume more of the child-rearing burden, and family-friendly work policies. As a result, some women have been forced to drop out of the work force, even if they'd prefer to stay.

This may be why Pearson's novel has struck a chord. It tells the story of Londoner Kate Reddy's daily struggle as a high-powered fund manager who loves both her job and her children. She has a nanny who squeezes her for ever-more money, a husband who can't run errands, and a boss who finds any mention of children distasteful.

The Bitch in the House explores the same territory, with a lot more rage. Editor Cathi Hanauer says it was born out of her "domestic anger" over the difficulties of juggling work and family with so little support. At least some of this anger arises from a notion still held by many in the U.S.—that, ultimately, women's place is in the home, not the office. But most mothers have jobs. Deal with it. Let's move on to the real problem—the lack of government policies that would make child care accessible and paid maternity leave universal. This is not, incidentally, just a woman's issue. In an AFL-CIO poll of its members, almost 80% of men as well as women named affordable child care a high priority.

In *The Bitch in the House*, novelist Ellen Gilchrist writes: "Family and Work. I can let them be at war, with guilt as their nuclear weapon and mutually assured destruction as their aim, or I can let them nourish each other." Is anybody listening?

Senior Writer Arnst works full-time and raises a child.



HARRIED: New books, TV's *Life With Bonnie* focus on working moms

THE BILL COMES DUE FOR CAPITAL ONE

loaded up on subprime accounts. Then the economy tanked

What's in your wallet?" That's the tagline for Capital One Financial Corp.'s lighthearted TV ads during yetis eager to fleece people pay too much interest on their credit cards. Those catchy ads, along with a proprietary approach to identifying consumer credit risks, have helped Capital One the nation's sixth-largest credit-card company, with an estimated \$9.2 billion in revenues this year and 20% or more annual profit growth in 1994.

Until this year, Capital One's system appeared flawless. Using sophisticated data-mining techniques to come up with the right rates, fees, and conditions for each customer, the company pitched a wide array of Visas and MasterCard—and had one of the industry's lowest levels of bad loans. Its charge-off rate, a key indicator of credit-card company health, was only 4.36% in the second quarter, vs. a weighted average of 5.5% for the top 10 card issuers. Capital One's risk-management methods, in fact, made it a Harvard Business School study, while *BusinessWeek* this year ranked it No. 47 among the top-performing public companies.

So one's handing out awards now, though. Over the past year, as rivals in high-risk, subprime credit-card markets—such as Provident Financial, Metris, and NextCard, ran into trouble, Capital One swooped down and scooped up many of their customers. Chief Executive Richard D. Fairbank bet that Capital One's credit-risk model would cherry-pick the winners. The result was an explosion of subprime borrowers—all told, about 10% of the 8.1 million customers Capital One added in the past year.

What Fairbank also bet, though, was a blast of bad debt. Charge-offs rose to 4.96% in the third quarter. Capital One expects them to reach the 6% range in the first half of 2003, before receding. Company execs maintain that they know what they were doing when they decided to take on more high-risk customers. Indeed, Fairbank says that in-



**FAIRBANK
SAYS CAPITAL
ONE'S CREDIT
RISK MODEL
ISN'T BROKEN**

BAD DEBTS ON THE RISE



vestors were warned early this year that bad debts would rise. He insists the company's risk management model isn't broken. The trade-off is what he expected: More charge-offs for higher profits. Card rates for subprime borrowers are 15.9%, vs. 8.9% for better credit risks.

Earnings did indeed jump 57% in the third quarter, to \$259 million,

and the company projects a 15% profit gain for 2003. But the market isn't buying Fairbank's explanation. Investors, stunned by the deteriorating credit picture, pushed the stock down 20%, to \$27.85, when quarterly results were an-

nounced on Oct. 16. That followed a hair-raising drop of 40%, or \$20 per share in July, after regulators, worried about the buildup of bad credit, told Capital One to boost reserves.

It isn't just the ill-timed expansion that's spooking investors. Much of their discontent can be traced to the likelihood that Capital One may lose some of its best methods for wringing out credit-

card profits. The Federal Financial Institutions Examination Council (FFIEC), a coalition of banking regulators, is getting set to crack down, industry-wide, on late fees and over-the-limit charges. Why? On some subprime accounts, balances rise even when customers make the minimum payment. Regulators want to give consumers some relief.

While Capital One won't say how much it earns from such charges, Fitch Ratings analyst Thomas J. Abruzzo estimates fee income is about 50% of the company's revenue, with over-limit and late fees "a substantial part" of that. The FFIEC has not said what it plans to do. But Fairbank understands the potential impact on his business and his stock. "I empathize with investors in an [unpredictable] environment like this," he says. He believes Capital One

can make up for lost fee income by raising rates and other fees and by expanding further into other markets. His targets include auto finance—where Capital One already advertises heavily on the Web—unsecured personal loans, and international credit cards.

But with regulators breathing down the company's neck, says Kathleen M. Shanley, a debt analyst at Chicago bond-research firm Gimme Credit Publications, "it would be fair to say I am skeptical the company can achieve its still-aggressive growth projections." Gimme Credit has put Capital One on its "bottom 10" list of U.S. financial companies with deteriorating credits.

So what's in your wallet? For Capital One investors, the unsettling answer lately has been "not much."

By Geoffrey Smith in Boston

EARNINGS

SOUND AND FURY, AND NOT MUCH ELSE

Higher third-quarter profits don't hold up under scrutiny

When something looks too good to be true, it probably is. Case in point: the 55% surge in third-quarter net profits, on a 1% sales gain, reported by the 85 companies in *BusinessWeek's* quarterly flash-profits survey. While corporate earnings are improving, there's unfortunately less to these numbers than meets the eye. Take out special charges, and income from continuing operations was flat compared with the previous year. Why the big difference?

For starters, the third quarter of 2001 was one of the worst in recent memory. On top of recession and damage from September 11, many companies took huge write-offs that sent third-quarter profits tumbling 55%. From such a low base, the only way was up. Although many companies also took write-offs this year, the sheer magnitude was much greater in 2001. So exclude such extraordinary items from both this year's numbers and last, and the seemingly strong profit growth disappears.



ACCOUNTING

CRUNCHED NUMBERS

S&P's "core earnings" figures show how low profits may be

What do big companies really earn? Between the bear market and prosecutions of CEOs for accounting fraud, investors badly want to know. But they might not like one of the latest answers: less than half what Wall Street says and about a third less than com-

panies themselves report under generally accepted accounting principles (GAAP).

That's the outcome of a yearlong search to identify "core earnings" by Standard & Poor's, like *BusinessWeek* a unit of The McGraw-Hill Companies. The main reasons for the huge differences? Rigorous accounting for stock options and pensions. Those two factors weigh heavily enough in the core earnings calculations to slice more than \$5 and \$6, respectively, off the roughly \$27 per share that companies in the Standard & Poor's 500-stock index reported as net earnings for the 12 months that ended in June. Wall Street's rose-colored numbers, collated by Thomson

First Call, put average earnings share at around \$45.

Naturally, not everyone is happy with S&P's downbeat numbers or the way that they're calculated. Even before published its findings on Oct. 24, so-called accounting experts said its methods were inconsistent. All the same, the numbers give investors a first glimpse of what truly clean accounting might look like.

For starters, the current valuation of stocks look awful. Shrinking the earnings companies report under GAAP by 31%, as S&P's core numbers do, cuts the average price-earnings multiple for the S&P 500 from a recent 33 to 47, a level likely to make stocks unattractive.

CURRENT QTR
(MILLION)

INDUSTRIALS

287,360

ABBOTT LABORATORIES	4,340
ALCOA	5,220
ASHLAND †††	2,100
BOEING	12,690
CATERPILLAR	5,070

COCA-COLA	5,320
COLGATE-PALMOLIVE	2,380
CONAGRA FOODS †	7,060
DELPHI	6,440
DUPONT	5,480

FORD MOTOR	39,580
GENERAL DYNAMICS	3,280
GENERAL ELECTRIC	32,120
GENERAL MOTORS	43,570
GEORGIA-PACIFIC	6,150

GILLETTE	2,160
INGERSOLL-RAND	2,510
INTERNATIONAL PAPER	6,340
JOHNSON & JOHNSON	9,070
KRAFT FOODS	7,210

MAYTAG	1,160
MERCK	12,890
NIKE †	2,790
NORTHROP GRUMMAN	4,210
OCCIDENTAL PETROLEUM	1,960

PEPSICO	6,370
PFIZER	8,720
PHILIP MORRIS	15,230
PULTE HOMES	1,850
SCHLUMBERGER	3,500

3M	4,140
UNITED STATES STEEL	1,900
UNITED TECHNOLOGIES	7,290
VISTEON	4,340
WHIRLPOOL	2,750

SERVICES

140,033

AMR	4,490
BANK OF AMERICA	N
BANK ONE	N
BURLINGTON NORTHERN SANTA FE	2,300
CITIGROUP	23,500

DOW JONES	352
FEDEX †	5,440
FLEETBOSTON FINANCIAL	N
GOLDMAN SACHS GROUP	5,870
HCA	4,920

% CHG.	EST. EPS (8/15)	REPORTED EPS	DIFF.		CURRENT QTR. SALES (MILLIONS)	% CHG.	QTR. PROFITS (MILLIONS)	% CHG.	EST. EPS (8/15)	REPORTED EPS	DIFF.
+33	0.52	0.52	—	HOUSEHOLD INTERNATIONAL	3,859.1	+11	221.2	-54	1.19	0.45	-0.74
+14	0.48	0.46	-0.02	J.P. MORGAN CHASE	10,527.0	-16	40.0	-91	0.59	0.01	-0.58
-43	0.33	0.23	-0.10	MBNA	NA	NA	398.0	-17	0.42	0.30	-0.12
-61	1.08	0.68	-0.40	McDONALD'S	4,047.0	+4	486.7	-11	0.42	0.38	-0.04
-43	0.67	0.46	-0.21	McGRAW-HILL	1,577.3	+3	276.2	+15	1.41	1.42	+0.01
+4	0.60	0.61	+0.01	McKESSON ††	13,690.6	+13	124.8	+58	0.42	0.43	+0.01
+8	0.48	0.47	-0.01	MERRILL LYNCH	6,860.0	-23	693.0	+64	0.68	0.73	+0.05
+12	0.57	0.57	—	MORGAN STANLEY	8,056.0	-22	611.0	-17	0.72	0.55	-0.17
+17	0.40	0.42	+0.02	NEW YORK TIMES	729.5	+5	59.0	+35	0.38	0.38	—
+108	0.07	0.10	+0.03	NORFOLK SOUTHERN	1,598.0	+6	126.0	+59	0.31	0.32	+0.01
230	0.29	0.47	+0.18	OFFICE DEPOT	2,870.8	+4	87.1	+40	0.27	0.27	—
NM	-0.10	-0.18	-0.08	SAFeway	8,057.0	+1	281.3	-9	0.60	0.60	—
+17	1.33	1.32	-0.01	SCHWAB (CHARLES)	1,031.0	+1	-4.0	NM	0.08	0.00	-0.08
+25	0.41	0.41	—	SEARS, ROEBUCK	9,669.0	-1	189.0	-28	0.86	0.59	-0.27
NM	0.88	-1.42	-2.30	SHERWIN-WILLIAMS	1,426.3	+4	111.3	+23	0.69	0.73	+0.04
NM	0.50	0.27	-0.23	SOUTHWEST AIRLINES	1,391.2	+4	74.9	-50	0.08	0.09	+0.01
+20	0.33	0.33	—	SUNTRUST BANKS	NA	NA	343.0	+3	1.22	1.20	-0.02
+163	0.57	0.53	-0.04	U.S. BANCORP	NA	NA	860.3	NM	0.47	0.45	-0.02
NM	0.32	0.30	-0.02	UAL	3,737.0	-9	-889.0	NM	-5.64	-15.57	-9.93
+19	0.59	0.60	+0.01	UNITED PARCEL SERVICE	7,754.0	+5	578.0	+2	0.54	0.51	-0.03
+73	0.51	0.50	-0.01	UNITEDHEALTH GROUP	6,247.0	+5	353.0	+53	1.04	1.12	+0.08
+63	0.79	0.77	-0.02	WELLS FARGO	NA	NA	1,444.0	+24	0.84	0.84	—
-3	0.82	0.83	+0.01	TECHNOLOGY	50,773.4	+1	4,958.4	+464	0.19	0.18	-0.01
+6	0.81	0.81	—	APPLE COMPUTER †††	1,443.0	0	-45.0	NM	0.02	-0.13	-0.15
+53	1.57	1.17	-0.40	GATEWAY	1,117.8	-21	-46.9	NM	-0.15	-0.15	—
+7	0.57	1.25	+0.68	IBM	19,821.0	0	1,694.0	-1	0.99	0.99	—
+55	0.55	0.54	-0.01	INTEL	6,504.0	-1	686.0	+547	0.13	0.10	-0.03
+13	0.39	0.38	-0.01	MICRON TECHNOLOGY †††	748.0	+56	-586.5	NM	-0.15	-0.97	-0.82
+87	1.27	2.06	+0.79	MICROSOFT †	7,746.0	+26	2,726.0	+112	0.43	0.50	+0.07
+37	1.81	1.83	+0.02	MOTOROLA	6,371.0	-14	111.0	NM	0.05	0.05	—
-11	0.37	0.30	-0.07	ORACLE †	2,027.5	-10	342.7	-33	0.07	0.06	-0.01
+38	1.38	1.38	—	SUN MICROSYSTEMS †	2,747.0	-4	-111.0	NM	-0.01	-0.04	-0.03
NM	0.42	1.04	+0.62	TEXAS INSTRUMENTS	2,248.0	+22	188.0	NM	0.10	0.11	+0.01
+8	1.19	1.21	+0.02	UTILITIES & TELECOM	35,492.3	0	2,611.0	NM	0.32	0.31	-0.01
NM	-0.25	-0.40	-0.15	AT&T	11,956.0	-8	207.0	NM	0.05	0.05	—
NM	1.58	1.46	-0.12	BELLSOUTH	5,542.0	-8	733.0	NM	0.53	0.39	-0.14
+17	0.63	0.50	-0.13	CONSOLIDATED EDISON	2,510.0	-4	286.5	+2	1.32	1.33	+0.01
NM	-2.39	-5.93	-3.54	DOMINION RESOURCES	2,597.0	+2	430.0	+25	1.51	1.54	+0.03
+166	1.42	1.45	+0.03	FIRSTENERGY	3,572.3	+83	324.5	+29	1.09	1.05	-0.04
+9	0.70	0.70	—	FPL GROUP	2,353.0	-6	153.0	-55	1.81	0.85	-0.96
-15	0.57	0.51	-0.06	SPRINT FON GROUP	3,805.0	-7	484.0	+317	0.36	0.54	+0.18
+15	0.81	0.72	-0.09	SPRINT PCS GROUP	3,157.0	+19	-7.0	NM	-0.13	-0.01	+0.12
-85	0.09	0.03	-0.06								
+27	0.49	0.52	+0.03								
-23	0.58	0.57	-0.01								
+12	1.04	1.00	-0.04								
-22	0.55	0.38	-0.17								

† First-quarter results

†† Second-quarter results

††† Fourth-quarter results

NM = not meaningful

NA = not available

Data: Standard & Poor's COMPUSTAT

Earnings Estimate Data Provided By Thomson Financial/First Call

many. Plus, the earnings yield on
cks falls to just 2%, or about half
yield of 10-year Treasuries.
&P's conclusions foreshadow the pos-
e results of an accounting overhaul.
re than 110 companies have an-
anced since May that they
l begin expensing stock op-
ns. Already, the Financial
counting Standards Board,
pper of GAAP, is mulling
ether to make companies es-
ate options costs quarterly.
erest is also gathering for
rhauling accounting for pen-
ns. On Oct. 21, FASB said it is
king to refashion its code so
t companies won't be able

to find as many loopholes as they do
nov.

But FASB's overhaul may take years.
In the meantime, Wall Street invest-
ment houses and research companies
like S&P aren't waiting. David M. Blitzer,

an S&P managing director, says GAAP
hides from investors the true risk and
cost to companies of their pension plans.
That's becoming crystal clear as more
companies 'fess up that they need to
pump cash into the plans to make up for
stock market losses.

Even if core earnings do not
become a standard, Standard
& Poor's results may add fuel
to the drive for accounting re-
form. The new numbers un-
derscore just how important it
has become for regulators to
hurry up and set the books
straight.

By David Henry
in New York

Cut to the Core

Per-share earnings for S&P 500 stock index companies
for the 12 months ended in June, 2002, according to:

WALL STREET ANALYSTS REPORTING TO FIRST CALL **\$44.93**

COMPANIES' REPORTED NET INCOME **\$26.74**

S&P'S NEW CORE EARNINGS STANDARD **\$18.48**

Data: Standard & Poor's, Thomson Financial/First Call

POLITICS

THE DEMS: IT'S TIME FOR TRIAGE

With funds tight, weak candidates won't get a helping handout

When Robert G. Torricelli pulled out of the New Jersey Senate race on Sept. 30, Democrats breathed a sigh of relief for more than one reason. Torricelli not only gave his party a chance to keep his seat, he also allowed it to save some \$10 million Democrats might have spent trying to save his hide. Now they can spend more on other candidates fighting for their careers—and the party's one-seat hold on the Senate.

As they sprint toward Nov. 5, both parties are breaking fund-raising records with a combined \$487.7 million tallied so far. Already, that's topping the mind-boggling \$450 million raised for House and Senate races in the 2000 Presidential election cycle. Yet in the final stretch, the Democratic Senatorial Campaign Committee (DSCC) has only \$13.2 million in the bank, compared to the \$21.5 million its Republican counterpart holds. And over the last month of the campaign, Republicans were expected to raise even more and spend some \$50 million in TV advertising alone. That will far outstrip whatever the Democrats

may ultimately raise. With a dozen Senate seats still in play, Dems are finding that their biggest-ever cash haul isn't big enough.

They can't count on help from the Democratic National Committee, which is also running short. As of Sept. 30, the committee had only \$4.8 million in cash—and debts of \$4.1 million. To raise some fast cash, the party has refunded \$6 million in funds earmarked for a new DNC building and asked the donors to reissue checks for use in races. The Republican National Committee, by contrast, has \$30.7 million in cash and no debt.

With so many contests still neck-and-neck, Democrats must perform serious triage. Some candidates will get the handout they need for an eleventh-hour ad campaign, but others won't. "We will not bring some of our potentially winnable [races] to the finish line," says Senator Jon S. Corzine (D-N.J.).

Democrats have turned off the spigot for such once-promising candidates as Oregon Secretary of State Bill Bradbury, who has all but lost his race against incumbent Gordon H. Smith. And Dems won't go whole hog in Texas, where ex-Dallas Mayor Ron Kirk was considered a long shot. But now Kirk is running a surprisingly strong race

against Texas Attorney General Cornyn, and the party can offer limited help. By Oct. 28, the DSCC have spent only \$4.5 million there. That's just a fraction of what the Republicans will spend in Texas, where ad campaign costs \$1.9 million a week.

In another key race, Dems will port embattled incumbent Paul D. Wellstone of Minnesota, but they won't match the GOP's largesse. Why? Betting on one candidate would mean scrimping elsewhere, such as in Missouri, where first-term Senator Jeanne Shaheen of New Hampshire, who has shot up in the polls against GOP Representative John E. Sununu. "They simply can't afford to lose a seat while focusing on another," pollster John Zogby.

Party officials, noting that too much advertising can be a turnoff, say they aren't worried. "At some point, you can't buy any more TV," says DSCC spokeswoman Tovah Ravitz-Meehan. Democrats also can count on the Sierra Club, unions, and other groups to offset the party's spending gap by buying their own ads and getting voters to the polls.

Still, demand for Democratic dollars far exceeds supply, and the flusher GOP is prepped for a last-minute TV blitz. "Republicans have the money to do whatever they want, wherever they want, whenever they want," says Jennifer E. Dunne, an analyst at the non-partisan *Congressional Political Report*. That's enough to make any Democrat queasy.

By Lorraine Woellert in Washington

HARD CHOICES



IN THE MONEY

◀ **JEAN CARNAHAN** MISSOURI A vulnerable incumbent who has dropped in the polls

TIM JOHNSON SOUTH DAKOTA Democrats need a win in Majority Leader Tom Daschle's home state

PAUL WELLSTONE MINNESOTA The Senate's leading liberal faces a tough challenge from a former Democrat

JEANNE SHAHEEN NEW HAMPSHIRE A little more money could help to capitalize on her momentum—and pick up a key seat

TOM STRICKLAND COLORADO Democrats can't back out now as Strickland makes late gains in a race that is going down to the wire

MARK PRYOR ARKANSAS The son of a former Senator, Pryor could edge out vulnerable GOP incumbent Tim Hutchinson

COULD USE HELP

RON KIRK TEXAS The late influx of cash he has received might not be enough to win this Republican-leaning state

MAX CLELAND GEORGIA His once-comfortable lead has eroded

FRANK LAUTENBERG NEW JERSEY A late start means his own deep pockets may not be enough

ON THE OUTS

▶ **ERSKINE BOWLES** NORTH CAROLINA He has an uphill race against GOP celebrity Elizabeth Dole

ALEX SANDERS SOUTH CAROLINA Party officials have all but given up on Sanders, down by double digits

BILL BRADBURY OREGON His once-promising candidacy never caught on



The

**“BUY US
OR BUY A
RABBIT’S FOOT”**

storage software company.

86% of the FORTUNE 500® rely on VERITAS Software for data backup and recovery.

veritas.com/recovery


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EDUCATION

EDISON: AN 'F' IN FINANCE

For-profit Edison Schools needs to make a profit soon

The messianic CEO of Edison Schools Inc., H. Christopher Whittle, has long assumed that investors and educators would give him plenty of time to prove that his for-profit company could revolutionize American education. With good reason: Since founding Edison a decade ago, Whittle has raised \$509 million—without ever coming close to turning a profit.

But time may finally be running out on his bold experiment. With Edison's stock now trading around 50¢, down from \$20 in early January, the equity market is closed. Edison's precarious financial position is forcing it to borrow funds at exorbitant rates of 12% and higher. And Edison's schools are under assault in some of its most important districts, from Dallas to Philadelphia.

True, most observers believe the company has the wherewithal to make it through the current school year. Despite heavy spending this summer to open new schools, Edison still has \$30 million in cash. "But this is their last chance," says

Trace Urdan, an analyst at ThinkEquity Partners, a boutique investment bank in San Francisco. By next June, Edison must pass its toughest exam yet—by proving that it can make money while effectively running schools in such tough places as Philadelphia. If it fails, Edison will likely either become a private company or face bankruptcy.

The stakes go far beyond the 80,000 students attending the 150 schools Edison now runs. "Edison is the bellwether for the entire for-profit school-reform movement," says Peter J. Stokes, executive vice-president at Eduventures Inc., a Boston market researcher.

Whittle's challenge: fixing the company before he loses all access to funding. While revenues soared to \$465 million for the fiscal year ended June 30, up

from just \$66 million in 1998, Whittle is pledging that "we will have our strongest financial year in our history." Specifically, he says, Edison will produce \$20 million in EBITDA (earnings before interest, taxes, and depreciation) in the fiscal year ending next June. Although that would still mean a net loss, it would be a huge turnaround from fiscal

1998, when Edison lost \$10 million on an EBITDA basis, even after excluding a charge of \$46 million in restructuring costs. To meet the target, Whittle says Edison is scaling back its growth opportunities. He's also curbing

the pricey practice of giving each school a home computer, which accounts for nearly half of its school-related capital spending. And he hopes to raise \$40 million to \$50 million by refinancing some \$80 million Edison loaned its charter schools.

Problem is, such austerity could weaken the appeal of Edison's education model and compound its already rocky relations with some of its biggest customers. Although Edison has been reporting improving test scores, contract disputes and other problems forced it to close schools, with 7,400 students, last year in Dallas, where Edison runs seven schools. It is terminating its contract at the end of this year. And now all eyes are on Philadelphia, where Edison assumed control of 20 schools in August—its biggest contract to date. "The opening of those schools was very chaotic," says Barry Goodman, communications director for the Philadelphia Federation of Teachers. But Paul Vallas, CEO of the School District of Philadelphia, says it's "premature to pass judgment. Edison is holding its own in the vast majority of the schools." Still, Vallas has withheld \$4 million due Edison until problems are fixed.

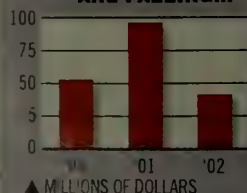
Many observers believe Whittle will ultimately choose to take the company private. "That would allow them to right their ship outside the fishbowl you operate in as a public company," says Michael Connelly, CEO of Moser Education Inc., a for-profit operator of 44 charter schools in six states. But Edison loses the Philadelphia contract, warns Stokes,

bankruptcy could follow. If Edison fails, the schools will survive in one form or another. The biggest blow will be to those who believe the private sector can play a key role in reforming public schools.

By William C. Symonds in Boston

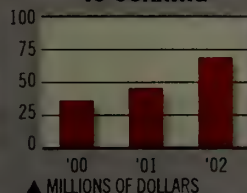
EDISON'S HARD LESSON

CASH RESERVES ARE FALLING...



▲ MILLIONS OF DOLLARS
NOTE: ALL FISCAL YEARS ENDING JUNE 30

...AND DEBT IS SOARING



▲ MILLIONS OF DOLLARS
Data: Company reports

from just \$66 million in 1998, Whittle's promise that size equals profits hasn't come true. Last year, Edison's spending on education and operating expenses still outpaced revenues by 10%. As a result, Edison's operating losses—including charges—jumped 88%, to \$76.7 million.

In an effort to boost confidence, Whit-



WHITTLE: Scaling back to cut costs

Royal  Skandia

HSBC Republic 

la vache qui rit



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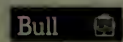
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COMMENTARY

By Robert D. Hof

WHY TECH'S HEAVYWEIGHTS STILL CAN'T CRUSH THE SMALL FRY

Everywhere you look, the strongest tech giants just keep on getting stronger. On Oct. 17, mighty Microsoft Corp. more than doubled its net income, to \$2.7 billion, just as most rivals' profits fell or disappeared. Dell Computer Corp.'s third-quarter shipments of personal computers jumped 23% from a year ago, far outpacing No. 2 Hewlett-Packard Co., whose shipments fell 5%. Even Cisco Systems Inc., despite struggling with the telecom meltdown, has hiked its market share of networking routers to 70%, from 60% a year ago. It's the same story with IBM, German software powerhouse SAP, and cell-phone leader Nokia.

Good for them. But the rise of these bruisers on steroids raises a troubling question: Will their increased dominance harm competition, raise prices, and reduce innovation? Microsoft's market power notwithstanding, the surprising answer is: not likely. For now, of course, the relentless tech downturn means a buyer's market. Yet even longer term, many customers aren't worried, confident that a recovery will spark a new round of innovation and competition. Says David Watson, chief technology officer for the HMO Kaiser Permanente: "The cycles of innovation don't seem to be dampening."

Corporate tech customers are sanguine, in part, because they often prefer dealing with the giants. During downturns, too, tech buyers shy away from startups that may go bust. A recent Merrill Lynch & Co. survey of tech buyers found that 80% are consolidating purchases with larger suppliers, vs. only 5% favoring smaller outfits. Office-products retailer Staples Inc., for instance, will soon cut its PC suppliers from three to one. Says Bob Parker, an analyst with AMR Research



Inc.: "People want one throat to choke."

Of course, buyers need to watch their own throats as well. Microsoft Corp., with no viable competition, recently hiked license fees for its Windows software, forcing many customers to direct scarce resources from other tech products.

The question is whether buyers, as they narrow their supplier lists, endanger the viability of struggling midsize or second-tier suppliers. Even large suppliers such as server maker Sun Microsystems Inc. and customer software supplier Siebel Systems Inc. are hurting today.

Moreover, reducing the pool of strong competitors could eventually come back to haunt technology buyers by narrowing the wide array of choices that has kept tech vibrant.

But despite the risks, tech customers are convinced that they will remain in the driver's seat. Even if smaller and midsize companies face tighter squeeze and dwindling resources, they believe small, innovative companies will continue to thrive in such markets as security software and wireless networking gear. Others are changing the game: Salesforce.com Inc. offers customer-management software online to nearly 5,000 clients. That's a cheaper, more flexible alternative to software from leaders Siebel and SAP. Such pressure keeps the giants on their toes.

There's another reason buyers needn't worry. Giants can be awfully nimble on their own, too. Thanks to its swift embrace of the Java software created by rival Sun, for instance, IBM logged a 27% jump in sales of Internet software in the third quarter. And in the key market for application servers, it gained nine points of market share last year, rising to a 31% share—nearly catching leader BEA Systems Inc.'s 34% share.

Perhaps most important, customers wield more power than ever thanks to a rising tide of industry standards. Software that conforms to agreed-upon specifications, such as Java, Linux, and the Internet data-interchange standard XML, prevents suppliers from locking in customers to their products as tightly as they once could—or Microsoft still can.

That power will only grow when the tech recovery eventually comes. While a few prominent giants clearly are turning on the heat during the downturn, most big tech suppliers are still cutting research and capital spending. That's the opening the giants always leave for upstarts in times like this. And it's why, when the economy turns, the tech industry's little guys will get another day in the sun.

Senior Correspondent Hof covers technology from Silicon Valley.

ON STEROIDS Although Microsoft, IBM, and Dell are bulking up, innovation still trumps size



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TECHNOLOGY

THE HUMBLE HANDHELD: A LAPTOP KILLER?

High-end PDAs are making inroads among the corporate crowd

Stanford University Medical Center physician Tony Burgos often treats Web-savvy patients who know more about new drugs than he does. That's why he considers his Palm Vx as essential as a stethoscope. "A handheld for medication information, dosage, and drug interaction is invaluable because it keeps you up to speed," he says.

Burgos is hardly the only busy professional whose work has been simplified by a personal digital assistant—a fact that hasn't gone unnoticed by PDA makers. Indeed, with potentially large new markets opening up for their products, PDA makers are set to engage in battle over the lucrative high end of the market. On Oct. 28, Palm Inc. plans to roll out two pricey, feature-laden models aimed at business and professional users, a move being closely followed by rivals Hewlett-Packard Co. and Toshiba Corp. Even newcomers Dell Computer Corp. and ViewSonic Corp. are trying to get in on the act.

The reason isn't hard to fathom. Through August, overall retail sales of PDAs were 8.2 million units, 6.5% less than last year. But sales to enterprise markets—corporations, health-care organizations, educational institutions, and the government—have jumped 8.6% this year. And Gartner Dataquest predicts that by 2004, enterprise buyers will account for 40% of handheld purchases, up from 27% now.

Price is a big factor, too. With retail PDAs getting steadily cheaper—the average price of a Palm has fallen from \$399 in 2000 to \$224 today—margins can be as low as 17%. By contrast, margins at the higher end can reach 40%. Moreover, companies are more likely to buy high-end products—and to upgrade more often than consumers do. Corporate buyers, according to Angel L. Mendez, Palm senior vice-president for



**A HANDHELD
IN EVERY
OFFICE?**

DATA: GARTNER DATAQUEST

ENTERPRISE SALES* OF PDAS IN MILLIONS OF UNITS

2001	2002	2003	2004
3.5	4.7	5.3	7.7
		Estimated	

* Includes sales to corporations, health care, educational organizations, and government

global operations, "are much more apt to buy the latest and the greatest."

Better margins are only part of the equation, though. With profits on hardware constantly under pressure from competition and new technologies, Dell, HP, and others see tech services—installation and maintenance, mostly—as the best way to grow in the future. To get corporate customers to buy such services, these companies hope to cement their position as one-stop shops for a broad menu of info-tech products, including PCs, servers, and—yes—PDAs.

The question, of course, is whether companies will divert a big chunk of their IT budgets on handhelds away

from laptops or other gear. To win battles over, HP, Dell, and Palm are crisscrossing their gadgets with business-friendly functions such as built-in wireless connectivity. High-end models like the \$600-plus iPAQ 5400 feature Bluetooth technology, which allows the handheld to connect wirelessly to printers, phones, and laptops over a short distance. Top-of-the-line handhelds also

offer Wi-Fi, which connects to high-speed broadband networks in coffeeshops, airport lounges, hotels, and offices. And these features help make the handheld as useful as the laptop. Models like the Palm and Toshiba Corp. are launching PDAs with faster processors, more memory, and better screens.

So, do cash-strapped corporations need these gadgets? For some, the answer seems to be yes. Crocker Sales Agency, a national outsourcing sa-

CLINICAL TOOL

Dr. Burgos can check new drugs, dosages, and interactions on a PDA

company, recently replaced most of its field notebooks with HP iPAQs. No longer do sales reps have to lug around laptops and enough batteries to last eight hours, says Chief Information Officer Charlie O'dorff. He also notes that purchasing and support costs are half what they were for the notebooks. For its part, Volvo has hired quality inspectors, who

use handhelds to enter and transmit data from U.S. ports to a central computer. As a result, a process that once took three weeks now takes minutes.

Sounds good, yet without such tangible benefits, many companies won't buy handhelds until the economy picks up, say analysts who track spending plans. For now, PDAs are evolving into a must-have business tool primarily at companies with big delivery operations, sales forces, or large inventories to track. But handheld makers are betting that their appeal will grow.

By Cliff Edwards in San Mateo, Calif.



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EDITED BY MONICA ROMAN

AOL'S ACCOUNTING WOES: NO BIG DEAL?

AOL TIME WARNER SENT A clear signal to federal investigators poring over the advertising deals at its America Online unit: The problems might not be very big ones. Based on its internal review of ad deals, AOL Time Warner said on Oct. 23 that it would restate financial results for the eight quarters ended June 30, 2002, reducing revenues by \$190 million. AOL CEO Richard Parsons noted that \$190 million represents 1% of AOL's total revenues during that period. AOL Time Warner says no further restatements connected with the ads will be necessary.

UNITED MAY YET AVOID BAILING OUT

UAL COULD DODGE THE bankruptcy bullet after all. The parent of United Airlines has refiled for \$1.8 billion in fed-

eral loan guarantees needed to pay debt due in November and avoid Chapter 11. Its first application, which included \$520 million in pilot pay cuts over three years, was rejected in August. This time, UAL's unions agreed to \$5.8 billion in concessions over 5½ years. The unions still must hammer out details, but the Air Transportation Stabilization Board has signaled that the wage cuts and the savings from firing 1,250 employees will be enough.

PARCHED AT TEXAS INSTRUMENTS

THE SEMICONDUCTOR SECTOR seems to be headed south once again. On Oct. 21, Dallas chipmaker Texas Instruments said new orders declined 7% in the third quarter, after a spring surge. The slowdown caused lower-than-expected quarterly earnings of \$188 million for TI, which is cutting 500 jobs. With orders weakening, TI expects that sales will drop 10% in the fourth quarter and profits will evaporate. TI says customers continue to ante up for chips for new wireless phones, but demand for parts for PCs, notebooks, servers, and peripherals has tanked.

NEW GUIDELINES FOR BEAN COUNTERS

ON OCT. 21, THE FINANCIAL Accounting Standards Board proposed switching from the current rules-based system to the principles-based accounting used by most of the world. A change from precise accounting rules to the broad principles that define good accounting may be the right step to take in the wake of recent corporate scandals. Under the current system, critics maintain, companies often concoct elaborate ways to get around accounting rules instead of basing their deci-

HEADLINER: PAUL ALLEN

ONE TROUBLED CABLE GUY

Paul Allen's wired world is looking increasingly tangled. On Oct. 22, Allen's majority-owned Charter Communications put Chief Operating Officer David Barford on leave, pending the outcome of a grand jury investigation into inflated subscriber counts and accounting irregularities. That sent Charter shares down 31%, to \$1.20; back in December, the company traded at \$16.

The share slide, coming after months of shareholder lawsuits, has slashed the value of Allen's stake in the nation's fourth-largest cable company by \$7 billion

over the past year. A slipping subscriber count recently led St. Louis-based Charter to cut revenue and cash flow forecasts as customers defected to satellite services. Charter expects to report \$1.4 billion in negative cash this year, but it says it has enough cash until things turn around in late 2003. The company is also cooperating with the grand jury. Insiders say Allen is holding off on plans to take Charter private, worried that a low bid would incite a new round of shareholder lawsuits.

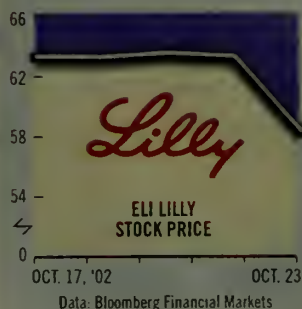
Ronald Gro



CLOSING BELL

DOWNER

Where's the Prozac? Eli Lilly shares skidded 8% to \$58.09 on Oct. 23 after the Indianapolis drugmaker warned fourth-quarter profits would fall 3% to 5% below forecasts. The reason? Generic competition is hurting its brand-name antidepressant and slowing sales of its other big medicines.



sions on sound underlying principles. For example, companies that own a certain percentage of another business must consolidate the two financial statements. But if they own just a fraction less, they don't. That rule allows accountants to treat the two stakes entirely differently, though they're nearly equal in size. Proponents of a principles-based approach say the shift will put the onus on accountants and companies to explain clearly the reasons why they have chosen a particular accounting treatment.

MARTHA IN THE MIRE

MARTHA STEWART LIVING Omnimedia is a lot closer to finding out whether the company can survive without its founder. The Securities & Exchange Commission is recommending civil charges—and a criminal probe by the Justice

Dept. is continuing investigations that she illegally traded shares of ImClone Systems and obstructed justice. Even Stewart is slapped with and criminal charges, could still carry on as CEO. Martha Stewart Living Omnimedia until those cases are solved, according to security lawyers. It wouldn't be until a settlement is reached that SEC would be likely to bar her from acting as CEO. And she's convicted on criminal charges, her sentencing would include a stipulation that she step down, lawyers say.

ET CETERA...

- George Soros will invest \$150 million in Qwest Communications' telephone-book unit.
- An FDA panel on Oct. 22 recommended approval of J&J's new drug-coated stent.
- Dynegy hired former DuPont Energy exec Bruce Williams as its new CEO.



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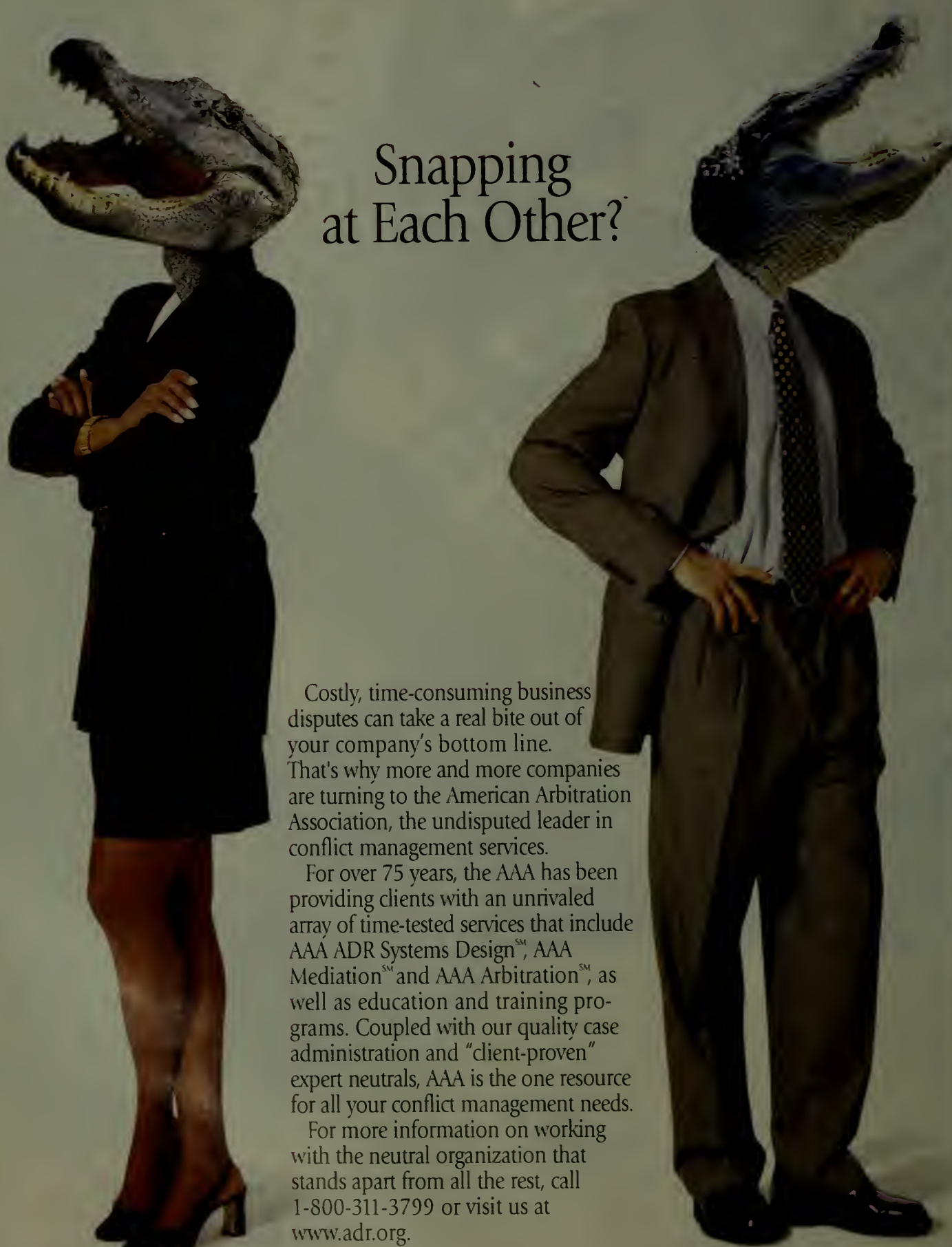
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EDITED BY RICHARD S. DUNHAM

DESPERATELY SEEKING SOME TRACTION FROM 'NASCAR DEMOCRATS'

No one can remember the last time a President held a Rose Garden ceremony to celebrate a new Food & Drug Administration regulation. But on Oct. 21, President Bush, with Health & Human Services Secretary Tommy Thompson at his side, announced rules making it easier to bring generic drugs to market. The regs, Bush said, will reduce the cost of prescription drugs...for many." The Administration had been working on the rules for months, but even industry lobbyists were stunned by the sudden announcement. They shouldn't have been. There's an election on Nov. 5.

The initiative is part of an intensifying battle over the campaign's Third Front. Voters overwhelmingly back the GOP on combating terrorism, and Democrats have been unable to gain any advantage from the sour economy. That leaves a set of domestic issues that may be the Dems' best chance to win control of Congress at least, hang on to the Senate.

The issues are all tied to growing fears of seniors and near-seniors over retirement security: Social Security, Medicare, soaring prescription drug costs, and shaky pensions. An Oct. 8-9 Fox News/Opinion Dynamics poll showed Democrats held a 16-point edge on health care and a 14-point lead on Social Security. "These could be the sleeper issues of this campaign," says pollster Andrew Kohut of the Pew Research Center for People & the Press.

While Dems perennially use Social Security to scare seniors, their target this year is broader: 50-plus voters, including many NASCAR Democrats—blue-collar workers who back Bush and the GOP on terrorism and Iraq but, spooked by a year-long stock market decline, worry about their retirement. In a low-turnout election, their support will be critical.

With Iraq and the Beltway sniper dominating the news, these issues are being fought out mostly in paid advertising.

So far, more than \$180 million, or a staggering 30% of all ad money, has been poured into messages about Social Security, Medicare, and health care, according to Campaign Media Analysis Group, an Arlington (Va.) research firm. By contrast, just \$9 million has been spent discussing terrorism.

In New Hampshire, the labor-backed Campaign for America's Future is mounting an assault on Representative John E. Sununu, blasting the GOP Senate candidate for supporting private Social Security accounts. The attacks have helped

Democrat Jeanne Shaheen erase a once-daunting gap. "It's the one issue where Republicans haven't blurred the differences," says Hans Riemer, the group's senior policy analyst.

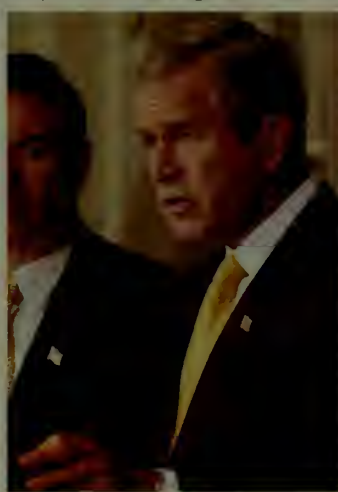
With attacks on private accounts also boosting Democrats in North Carolina and Colorado Senate races, "there's lots of concern" among Republicans, says Michael Franc, a vice-president at the conservative Heritage Foundation.

No wonder Bush and GOP candidates have responded ferociously. In both South Dakota and Minnesota, Republicans are hammering incumbent Democratic senators for raising taxes on Social Security benefits. Dems "have records to attack," says White House political director Ken Mehlman.

At the same time, the Administration is sending a kinder, gentler message about Medicare. On Oct. 21, HHS rolled out \$25 million in taxpayer-funded ads. No overt politics, just a reminder that Medicare is "helping you help yourself." And the Labor Dept. is proposing new protections for 401(k)s.

Democrats won't win this election just on close-to-home issues like Social Security and health care. But unless Dems can use them to energize voters, the party is looking at a long night on Nov. 5.

By Howard Gleckman, with Lorraine Woellert and John Carey



RX: Thompson and boss

CAPITAL WRAPUP

MOOING WEBSTER

Facing an Oct. 28 deadline to name a new accounting oversight board, SEC Chairman Harvey L. Pitt is having to twist arms to find a chairman. He is trying to recruit former FBI and CIA chief William H. Webster—even though Webster, 78, has told friends he's not sure he wants the post. Webster worked as a securities lawyer before serving as a federal judge and Washington's favorite fix-it man. But that was long ago, and reform advocates say the demanding job requires

a more vigorous presence. Pitt sought Webster after caving in to GOP lawmakers who objected to pension-fund executive John H. Biggs.

WAR BOOMERANG

► While Administration officials insist they're not playing politics with Iraq, why has the President toned down his rhetoric in recent days? Perhaps because an Oct. 6 Gallup Poll suggests his bellicosity was doing more to motivate dovish Democrats than it was to stoke the fires of pro-war Republicans. The poll found that likely voters who

cite Iraq as the top issue in the Nov. 5 election favored Democratic congressional candidates by 56% to 40%.

THE RUDY FACTOR

► GOP candidates are lining up to have ex-New York Mayor Rudy Giuliani cut commercials calling them "my friend." The latest: New Jersey Senate hopeful Douglas Forrester, who trails Democrat Frank Lautenberg in the race to succeed disgraced Senator Robert G. Torricelli. But is Giuliani's considerable popularity transferable? Only 3 of his 9 endorsees are leading.

JAPAN

RETHINKING TOKYO

Can Minoru Mori make it more livable?

For a center of global commerce, Tokyo has always been something of a disappointment when it comes to architecture. The city's skyline is fragmented and buildings that please the eye are rare. And although Tokyo boasts a thriving nightlife, downtown residents' housing choices are usually limited to colorless apartment blocks with little in the way of green space or parks.

Minoru Mori is out to change all that. Japan's most daring property developer, Mori, 68, has strung together a series of projects that marry sleek skyscrapers full of first-rate office space with apartments and stores, all surrounded by plenty of greenery. His goal: to open up new living and working space downtown that will give current residents new options and lure suburban salarymen eager to say *sayonara* to long hours on the train. "The separation of work and living makes for too much commuting and an unattractive environment," says Mori, president and chief executive of the privately held Mori Building Co. "People can't enjoy the night life, and there's no community."

Mori's latest bid to ease Tokyo's urban ills: a \$4 billion project called Roppongi Hills, his most ambitious development ever. The 27-acre site in the capital's entertainment district includes more than 4.3 million square feet of office space, four residential towers with 840 apartments, a hotel, an art museum sitting atop a 54-story office tower, and dozens of stores and restaurants. "My vision is to create a city within the city with everything you need for daily life," Mori says.

Trouble is, he's not the only visionary in town. With land prices down some 75% since the early 1990s, interest rates near zero, and new laws that make it easier to piece together chunks of land for big developments, Tokyo is undergoing a building boom not seen in nearly two decades. Mitsubishi Estate Co. just opened its 1 million-sq.-ft. all-new Marunouchi Building. The 43-story Shiodome City Center near Tokyo Bay opens in January, adding 2.2 million sq. ft. of space. Come September, the 32-story Chiyoda First Building will add another 650,000 sq. ft.

This giant facelift might make Tokyo a more attractive city, but it will also add to growing softness in the real es-

tate market—since most of the developments were planned when the economic outlook was much more bullish. In 2003, 1 million sq. m of top quality office space will come on the market, according to real estate consultants Colliers Halifax. Vacancy rates have already shot up from 3.5% in early 2000 to 6% today. And vacancies may rise to 10% over the next two years—close to the 14% reached in 1994 as the 1980s property bubble completely burst. That could send rents down a quarter by 2004, says Jim Fink, general manager of Colliers leasing division. "There is a significant amount of new space coming on-

BIG DREAMS

BUILDING / Location

WORLD FINANCIAL CENTER
Shanghai

ROPPONGI HILLS **MODEL OF SHANGHAI PROJECT**
Tokyo

ATAGO GREEN HILLS
Tokyo

HSBC TOWER
Shanghai

Since 1955, Mori Building Co. has developed nearly 100 projects. Many are influenced by modernist architect Le Corbusier. Here are some of the largest:

DESCRIPTION	SIZE (SQ. FT.)	COST	COMPLETED
A 1,500-ft., 101-story office tower that will be the world's tallest building	4 million	\$800 million*	2007**
A sprawling mix of office towers, upscale apartment buildings, and cultural facilities	8.2 million	4 billion	April, 2003
Office and residential space, plus a broadcasting museum and Buddhist Temple	1.6 million	880 million	October, 2002
A 46-story office tower in the ultramodern Pudong district	1.3 million	210 million	May, 1998

*30% owned by Mori **Projected

Data: Mori Building



MASTER BUILDER

Mori's \$4 billion project is his most ambitious

Ikoma/CB Richard Ellis in Tokyo.

The question, though, is whether Mori is overreaching with Roppongi Hills. Mori Building has financed the development with \$800 million of its own capital and \$1.3 billion in loans from a syndicate of lenders that includes the Development Bank of Japan. That pushes the company's overall debt load to \$5.6 billion. True, Mori Building has scads of great assets. But that's a heavy load for a company that brought in about \$620 million in revenues and earned \$47 million in the fiscal year ended in March. However, Mori says: "We don't have any problems with finance."

Maybe not, but potential tenants are playing hardball. Goldman, Sachs & Co.—the project's anchor tenant, expected to take a quarter of the office space—has spent months wringing out concessions Japan's lousy economy, staff cuts by foreign companies, and the explosion in new office space "should put even greater downward pressure on rents," figures

Keiko Otsuki, a real estate analyst with Morgan Stanley. Mori acknowledges that he had to make concessions that lower Goldman's costs by some 20%, but says it's worth it to have a high-profile tenant that will attract other financial companies to the project.

To his credit, Mori managed to come out of the 1990s' property bust unscathed by avoiding the golf course and resort deals that felled other Japanese developers. So he may well have a winning plan this time around. But when Roppongi Hills was on the drawing board, most analysts figured that by the time it was built Japan would be

growing again and foreign companies would be flocking to Tokyo. It hasn't worked out that way. Mori's vision may be what Tokyo and its salarymen need. But it remains to be seen whether they'll be able to afford it soon enough for Mori to make his money back.

By Brian B. Kanner
in Tokyo

every year through 2010," he says. Mori isn't worried. He says that while a lot of space is coming onto the market, it doesn't represent a glut anywhere near what Tokyo saw in 1994. Furthermore, Mori says all of the retail space and 75% of the office space in Roppongi Hills has already been rented. Apartments—costing between \$2,000 and \$7,000 per month—won't start renting until early next year. "This is a very popular area, and we strongly believe our occupancy rate will be very high," Mori says.

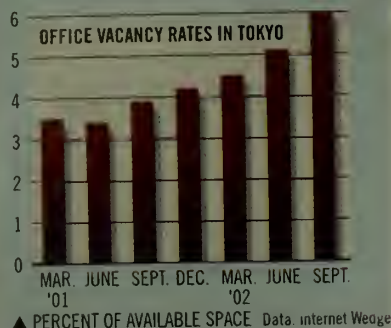
As if Roppongi Hills weren't ambitious enough, Mori's company announced last month it will restart construction of a 11-story skyscraper in China called Shanghai World Financial Center. The 1,500-foot-high building—the world's tallest—was put on hold in 1998. But with another project in Shanghai nearly 50% leased, Mori figures the time is right for the tower, which will dominate Shanghai's new Pudong district.

That Donald Trump-like impulse for grandiose is pure Mori, who, like Donald, hails from a family of property magnates. His father, an economics professor-turned-developer, launched the company in 1955. Some 20 projects later, thanks to a threefold increase in property prices during the late 1980s, he

had become one of Japan's richest men. When his father died in 1993, Mori and younger brother Akira split up the real estate portfolio and went their separate ways. Akira is now president of Mori Trust Co. and has no formal business ties to Mori Building. "We're rivals—in a good way," Minoru says.

Their investing styles couldn't be more different. Akira Mori is a conservative investor and a tough negotiator on leases. His older brother, on the other hand, likes big, expensive projects. Mori's Atago Green Hills project includes a Buddhist temple. His Motoazabu Hills development features a 29-story apartment tower and two other buildings that are surrounded by greenery. Mori is heavily influenced by the modernist architect Le Corbusier, who advocated high-rise towers set in parks. Indeed, Mori owns a major collection of drawings, paintings, and sculptures by Le Corbusier. "His ultimate motive is to reshape the urban environment," says John M. Tofflemire, a director with

GROWING ROOM



COMMENTARY

By Stan Crock

NORTH KOREA: WHY DIPLOMACY IS BUSH'S ONLY WEAPON

The hardliners vs. the pragmatists. Those battle lines have been drawn from Day One of the Bush Administration. Representing the hardliners is Defense Secretary Donald H. Rumsfeld, a man who scorned alliances and the rhetoric of arms-control treaties. For the pragmatists: Colin Powell's State Dept., a collection of career diplomats steeped in the craft of consensus-building.

Nowhere has the clout of Rumsfeld & Co. been felt more keenly than in Washington's handling of

tacking the North and destroying its weapons program simply isn't an option. Such a conflict would have a disastrous impact, since Kim would probably unleash a killer wave of conventional weaponry into South Korea and launch missiles into Japan. Thus, the only way to deal with North Korea is through sophisticated diplomacy. That means the Administration must use the tools it has often derided—coalitions, arms-control accords, weapons inspections.

The key to the new U.S. policy to-

U.S., Seoul, Tokyo, and Pyongyang agreed that the North would halt its plutonium-based nuclear-weapons program in return for oil and the construction of two light-water nuclear reactors. Given Pyongyang's revelation, some Administration officials now want to kill the agreemer

But South Korea and Japan disagree. Seoul has pursued a policy of engagement with the North for nearly five years, and Tokyo is on the verge of resuming talks to normalize ties. In a meeting in Seoul on Oct.



PYONGYANG BOMBSHELL

Kim Jong Il (above) has admitted to having a nuclear program

North Korea. The hardliners have pushed a policy of isolating Pyongyang, a junior member of the Axis of Evil, and openly rebuking South Korea for getting too close to its erstwhile enemy. Now, Dear Leader Kim Jong Il has admitted what the hardliners long suspected, that the North has an active program to develop nuclear weapons. What's more, Kim hasn't even apologized for his nefarious act.

And yet for all this provocation, an amazing thing seems to be happening. In the case of Kim and his bomb, the pragmatists are getting the upper hand in the White House. Under their influence, President George W. Bush is sounding downright conciliatory toward the oddball dictator. What this amounts to is a test case: Which works better—the politics of global confrontation or the dance of traditional diplomacy?

The choreography is intricate. At-

ward North Korea: Get your friends to do the heavy lifting. Washington is pressing Seoul, Tokyo, Beijing, and Moscow to lean on Pyongyang to give up its nuclear weapons program. The U.S. wants these countries "to convince the North Koreans they would pay too heavy a price" in terms of economic aid and political support if they continue their drive to join the nuclear club, says a senior Administration official. Bush will push this case when he meets with the leaders of South Korea, Japan, and Russia at the Asia-Pacific Economic Cooperation (APEC) meeting in Mexico on Oct. 26. Bush will also hash out this strategy with Chinese President Jiang Zemin in Crawford, Tex., on Oct. 25.

The challenge for the pragmatists won't end at APEC, though. Pyongyang's neighbors are making it clear that they may not bow completely to Bush's wishes. In 1994, the

21, South Korean and Japanese officials agreed that the 1994 pact is vital to stopping the North's nukes. For starters, the two countries have invested nearly \$1 billion to pay for building a quarter of the project.

Maybe the pragmatists can find a way out of this impasse by getting Pyongyang to agree to arms inspections. For that to happen, the U.S. will have to break down and open a real dialogue with the North. What would really help is if Bush assured Pyongyang that the U.S. does not intend to invade the North.

Impossible for Washington's hardliners to swallow? Maybe not. Bush took a tiny step toward reassurance on Oct. 21, when he said the crisis can be solved "peacefully." Soft rhetoric, alliance building, going halfway—this White House may yet be more flexible than anyone ever imagined.

With Moon Ihwan in Seoul



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RUSSIA

MEET THE NEW GLOBAL GRAIN GIANT

Russia's record exports have the EU, for one, alarmed

Just three years ago, Russia was on the breadline, negotiating with the U.S. for a 5 million-ton food aid package it desperately needed after its second poor harvest in a row. Now, in a startling about-face, Russia is harvesting bumper crops and giving established grain exporters, such as the European Union, Australia, the U.S., and Canada a run for their money. It's even on track to beat records set by the czarist regime almost a century ago, when Mother Russia was the world's breadbasket. "Now that other countries have cut back exports [because of drought], we have a chance to occupy a new niche in the market," says Yury Ognev, general director of Roskhleboprodukt, a former state-owned grain trading company bought up by metals magnate Vladimir O. Potanin last year.

Thanks to good weather and investments by new agribusiness barons such as Potanin, Russia is likely to match or beat last year's record grain harvest of 85 million tons. SovEcon, a Moscow agricultural research agency, estimates that exports in the 2002-03 agricultural year starting July 1 will rise nearly

50%, to 10 million tons. That would wipe out the 8 million-ton record set in pre-revolutionary Russia back in 1913, and bring in revenues of \$850 million.

Most of Russia's grain goes to Italy, Greece, Spain, and Northern Africa. With labor and farming costs less than half of Canada's, Russia is well-placed to win market share from suppliers in Australia, Canada, and the EU that have been hit by drought and flooding. Russian milling wheat meets EU standards. Priced at \$35 to \$95 per ton, it is \$50 below U.S. wheat of the same quality, and \$20 below EU wheat. Russia hopes that the low prices will cement its hold on new markets.

That prospect is sounding alarms in the EU. Brussels is weighing new import quotas that would keep out Russian and Ukrainian grain. Such a move raises the threat of a trade war with Russia.

ADVANTAGE Cheap labor lowers Russia's prices

Trade Organization. "While European countries are calling on others to be liberal and open, they do the complete opposite when it touches their own interests," says Russian Agriculture Minister Alexei Gordeyev. Russia is considering setting quotas on imports of European meat products in retaliation, he adds.

Despite the two bumper harvests, Russia is far from having the weight it had in czarist days, when it supplied one-third of global markets. Russia's exports of 4.2 million tons of wheat last year are far behind the 26 million tons exported by the U.S. That won't change unless Russia can construct new ports, terminals and improve its railroad system to ship surplus grain cheaply.

That's where the financial muscle of the new barons of Russian agriculture comes in. Russia's main port on the Black Sea, Novorossisk, is overloaded, and routes through Baltic ports are getting clogged, too. So Igor Potapenko, founder of the Moscow-based Razgulya Ukrros agriculture holding company, is in negotiations with the European Bank for Reconstruction & Development over its possible participation in his project to complete a \$14 million grain terminal on the Azov Sea by next year. "Russia's potential as a world player on the grain market is huge," says Potapenko. Roskhleboprodukt plans to spend up to \$100 million on a new deepwater terminal at Novorossisk, as well as terminals on the Azov and Baltic Seas.

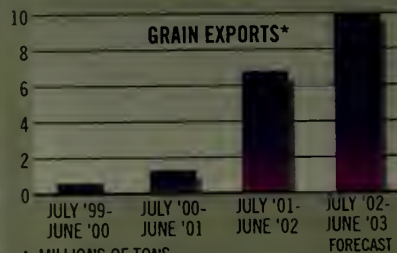
So far, so good. But how long can Russia hold on to new markets after a decade of farm-sector neglect? Most new

agribusiness owners are starting to plough millions of dollars into equipment and fertilizer. But the really big bucks won't come until the government gets a new farm insurance program on the ground. Meanwhile, Russia will continue to enjoy its edge in cheap labor and abundant land.

By European standards, Russian farmland currently is underfertilized by a factor of ten. If farmers just increased their use of fertilizer, output would soar. The czars would be proud.

By Catherine Belton in Moscow

RUSSIA: FROM BREADLINE TO BREADBASKET



▲ MILLIONS OF TONS
*PRIMARILY WHEAT; ALSO BARLEY AND OTHER GRAINS
Data: SovEcon, State Customs Committee



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ROSE BRADY

THE MAN WHO MAY DETERMINE WHETHER THE U.S. ATTACKS IRAQ

ans Blix has one of the world's toughest jobs. The 74-year-old Swede is executive chairman of the awkwardly named U.N. Monitoring, Verification & Inspection Commission (MOVIC)—the outfit in charge of finding and destroying weapons of mass destruction in Iraq. If the Security Council sends him and a team of 80 inspectors back into Iraq—as seems likely to happen, as early as late November—Blix could play a critical role in determining whether the U.S. goes to war against Saddam Hussein. “That puts a lot of pressure on Blix and on the inspectors,” says Richard Spertzel, a microbiologist who led a U.N. biological-weapons inspection team in 1995-98. The return of U.N. weapons inspectors to Iraq is widely seen as Saddam's last chance to prevent a military attack on his country. On Oct. 21, President George W. Bush declared he was going to rely on diplomacy “one more time” to disarm the Iraqi strongman. A senior administration official says that the U.S. wants inspectors to test whether or not Saddam has made “a strategic shift”—a serious decision to agree to the dismantling of programs for producing biological, chemical, and nuclear weapons, as well as long-range ballistic missiles, rather than face an attack. The Administration's assumption is that Saddam will resist U.N. demands for “immediate, unconditional, and unrestricted” access to suspected weapons sites. If Blix reports such resistance to the U.N., the U.S. could consider that a sufficient cause for launching a war. The fear is growing among hawks in Washington that the inspection process, instead of aiding the U.S. cause, will prove the Administration's plans for toppling Saddam. “The inspections are a trap. They are highly unlikely to get [Iraqi] armament, as the doves want, or provide a pretext for war, the hawks want,” says Kenneth M. Pollack, an Iraq expert at Brookings Institution's Saban Center for Middle East Pol-



Blix: Aggressive inspector?

icy. For starters, Bush has yet to win the diplomatic battle over the inspectors' mandate, which will be set out in a new Security Council resolution. China, France, and Russia are resisting U.S. proposals for a tough resolution warning Saddam of “severe consequences” if he fails to comply.

But even if the Security Council approves the U.S.-sponsored resolution, the Administration risks losing momentum vital to a swift execution of the war. A key reason is timing. If the U.S. wants to launch a military operation against

Iraq, it has about a six-month window, until next April, before it becomes too hot in Iraq for soldiers wearing protective suits against chemical and biological weapons to fight.

The clock will be ticking as soon as the resolution passes. Iraq would have seven days to accept it and 30 days to submit a report disclosing its programs for developing weapons of mass destruction. Only then would inspectors go in. To drag out the process, says one former inspector, “Iraq no doubt will offer temporary cooperation.” If the inspectors find nothing in the 105-day deadline the U.N. is considering giving Blix to report back, the effect could be to delegitimize the Bush Administration's argument for attacking Iraq. U.S. plans to launch a war in December or January would also be stymied.

To avoid this quagmire, the Administration is hoping that Blix, who headed the International Atomic Energy Agency for 16 years, will lead what U.S. officials call “aggressive” inspections. Blix has said little about how his team will tackle its job. But in a recent lecture to inspectors training in Vienna, he declared: “I am sure the [Security] Council will not tolerate any cat-and-mouse game, and it will expect [us] to report any such play immediately.” Saddam Hussein's fate—and American war plans—could well depend on how Blix handles that challenge.

With Stan Crock in Washington

GLOBAL WRAPUP

INDUSTRIAL ICON IN TROUBLE

Europe's No. 2 engineering company, ABB, is struggling to survive after management's shock third-quarter profit warning drove its share price down by almost two-thirds on Oct. 22 and a further 21% on Oct. 23. The automation-to-power technology group, which admits it has underestimated the scale of its financial and operational problems, has failed to cut costs and slash debt as much as new CEO Jürgen Dormann had predicted. Analysts say that ABB's short-to-

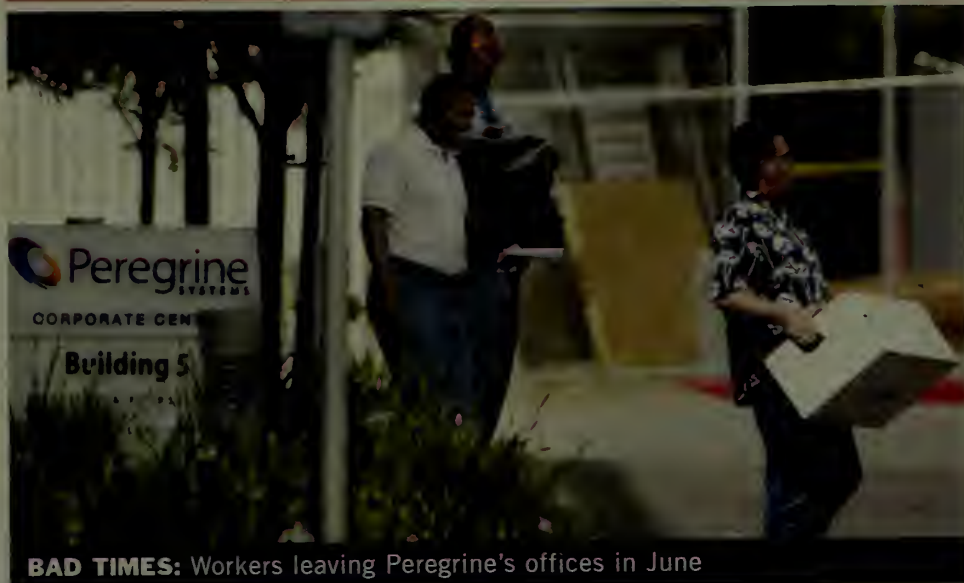
midterm cash-flow outlook is dire and that, given the slumping world economy, demand for its products is unlikely to revive before 2004. The biggest worry is that the group's customers may defect for fear ABB may not be around to service their purchases. To make matters worse, ABB faces bigger-than-expected asbestos insurance liabilities in the U.S.

Dormann, who denies ABB is close to collapse, says he hopes to limit those liabilities, possibly by filing for Chapter 11 protection for its U.S. subsidiary, Combustion Engineering. He

also says market rumors that the group needs to refinance \$3.7 billion of debt due to be repaid over the next 12 months are unfounded. But investors fear that U.S. courts could rule that asbestos claims extend beyond Combustion Engineering to the parent company. And they are worried that, despite Dormann's promises, the group's cash-flow problems will force it to refinance its debt. “Management has lost investors' trust,” says Christopher Watts, an analyst at Frankfurt's private Bank Metzler.

By David Fairlamb in Frankfurt

Information Technology



BAD TIMES: Workers leaving Peregrine's offices in June

SOFTWARE

DID PEREGRINE BULLY ITS PARTNERS?

Internal e-mails suggest it may have pressured distributors to buy products they couldn't sell

Late last year, Peregrine Systems Inc. looked formidable. The San Diego software company was heading toward a record year, with revenues exceeding \$500 million. Peregrine was emerging as the leading maker of so-called asset management software, which helps large companies manage vast systems, from computer help desks and PCs to company cars. More than 5,000 companies, from Bayer to Panasonic, had snapped up its products, thanks in part to its aggressive sales force.

Far too aggressive, it turns out. The company goosed revenues by pressuring distributors and resellers to order more products than they believed they could sell quickly, without building up inventories, according to former distributors, resellers, and former Peregrine executives. "The sales channel became a dumping zone for Peregrine," says one former reseller.

The consequences have been disastrous. Peregrine announced in June that the \$1.3 billion in revenues it reported over the past three years may have been overstated by as much as \$250 million. This prompted Peregrine to seek Chapter 11 protection in September—the biggest software bankruptcy ever. Now, customers are waiting to see if a key software provider will survive, and the Securities & Exchange Commission is investigating possible accounting fraud.

Already, a spring investigation by KPMG LLP has found more than eight potential accounting violations, most related to distribution channel sales. KPMG says in an SEC filing that one potential violation was

booking sales that either didn't take place or that resulted in returns that were not accounted for properly. It was this filing, pointing to possible fraud, that exposed the troubles at Peregrine and led to the meltdown. Peregrine execs say they have taken "decisive" action to address the problems.

Now, new details are emerging. E-

The San Diego
Union-Tribune.

Hole gets deeper for Peregrine

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mails obtained by *BusinessWeek* provide a look at Peregrine's relentless sales staff in action—promising concessions to a sales channel partner who agreed to buy \$3 million worth of a product. In the midst of the worst tech downturn ever, Peregrine apparently attempted to sidestep a sales decline, foisting it instead on its distributors and resellers.

It wasn't just the accounting that went awry. Interviews with more than a dozen former employees and partners paint Peregrine as a badly mismanaged company. Peregrine made 14 acquisitions, including main competitor Remedy Corp., in three years, but failed to fully integrate the products or sales forces. Peregrine sales reps battled ferociously with each other for accounts. "Customers saw this going on," says one former sales executive. "That hurt our relationships with them." Some frustrated insiders referred to the company's two leaders, then-CEO Stephen Gardner and Chief Technology Officer Frederic B. Luddy, as "the two left feet," says one former executive.

Peregrine readily admits to management missteps. Luddy, who still works for Peregrine, agrees that the company's core products "were not as integrated as they could be." And CEO Gary G. Greenfield, who was brought in to clean up the mess, says: "We pushed our partners too hard." Gardner, who could not be reached for comment, resigned in May, when the company announced it was investigating accounting irregularities.

The worst problems were in sales. Channel partners say Peregrine's sales managers often strong-armed them into signing purchase orders for millions of dollars' worth of products long before customers were lined up, a practice known as stuffing the channel. Those who balked were sometimes told that they might be cut off from Peregrine's future offerings—a serious threat to some small resellers for whom Peregrine was a mainstay.

Stuffing the channel isn't illegal. But the KPMG filing says Peregrine improperly classified some unrealized revenue from products that were returned or not paid for as "acquisition costs" or "other." Returned products should have been subtracted from revenues. Unpaid accounts are supposed to be listed as bad debt. Hiding such costs in one-time charges can give investors a false picture of rapid sales growth. If true, "it looks like rampant fraud," says former

SEC chief accountant Lynn E. Turner, after reading the KPMG filing. He's now director of the Center for Quality Financial Reporting at Colorado State University in Fort Collins, Colo.

In its filing, KPMG also points to evidence that Peregrine provided side agreements excusing channel partners from paying for orders. One possible example, uncovered by *BusinessWeek*, is



UNDER A CLOUD Critics say that former CEO Gardner, who resigned in May, presided over a company that was badly mismanaged—or worse

a December, 2001, deal with Seattle distributor Rainier Technology Group Inc. Sources familiar with the transaction say Rainier was pressured into signing two purchase orders totaling \$3 million for copies of Xanadu, a new package of Peregrine products designed for resellers to offer as a service to midsize companies.

Insiders say that technical problems held up Xanadu. In a March e-mail, obtained by *BusinessWeek*, Peregrine's vice-president for partner relations,

simply reflect his efforts to resolve dispute in "an amicable way." He added, "In reference to the other allegations, I have personally not conducted business with partners in this way."

It is still unclear whether Peregrine booked the transaction as a sale. Doing so would be a violation of SEC rules. Officials at Rainier declined to comment on any possible accounting violation at Peregrine.

CEO Greenfield is working furiously to salvage what's left of Peregrine's reputation. He tells jittery customers he's refocusing on the flagship asset management software. He has divested properties worth more than \$100 million, including supply-chain management software that Peregrine took on in its acquisition binge. And the company promises customers a new, more integrated software package within six months. "We are confident about our ability to grow the products and support them," says Karen Stefanik, director of information systems for Bayer, a Peregrine customer.

Still, competitors are swarming. Peregrine's biggest rival, Computer Associates International Inc., which has a strong reputation for brass-knuckled sales tactics, is targeting Peregrine customers. In California, CA says it has nabbed 25 accounts. Analysts predict new customers will stay away. "They've lost their credibility," says META Group Inc. analyst Michele Hudnall.

Greenfield remains confident. "Is our reputation tarnished? Maybe," he says. "But you can always polish silver again." Still, the allegations of management misdeeds will make it difficult for Peregrine to regain its former luster.

By Arlene Weintraub
in San Diego

PEREGRINE'S PLOYS

The SEC is investigating Peregrine's accounting practices. According to a filing from former auditor KPMG, these are some of the problems

RESELLERS Peregrine unloaded software on resellers—some of whom did not have customers lined up—then possibly booked much of the hoped-for sales as revenue prematurely.

ACCOUNTS RECEIVABLE The company financed some of its accounts receivable with three banks, but improperly listed the transactions as sales rather than loans.

FINANCIAL REPORTS Peregrine listed some of its bad debt and unrealized revenue as "acquisition costs" or "other." Experts say this hides ugly numbers from investors.

Data: KPMG

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A MAN, A PLAN, NEW YORK

Inside Dan Doctoroff's passionate campaign to land the 2012 Summer Games for a wounded city

Dan Doctoroff seems an unlikely point man for New York City's bid to host the Summer Olympics. You could go out for coffee in the time it would take for this middle-aged ex-investment banker to huff over the low hurdles. He doesn't know squat about putting a shot, and he hardly seems the type whose heart races at the sight of synchronized swimming. New York isn't even Doctoroff's hometown. He's from Michigan.

Doctoroff has been the moving force in getting America's most complex city to pursue the world's most complicated sports spectacle for one simple reason: He doesn't just think big—he thinks enormous. "Dan tends to look for larger-than-life opportunities," says friend and ex-business partner Andy Nathanson. "I'd call him a cogent dreamer."

Dreams don't get much bigger than hosting an Olympics, and Doctoroff is moving closer to realizing his. On Nov. 3, the U.S. Olympic Committee will choose either New York or San Francisco as America's entry in the race to host the 2012 Olympics. The International Olympic Committee will pick a global winner in 2005 (table, page 76).

To hear West Coast boosters tell it, victory will go to the City by the Bay. Not only does San Francisco boast better weather, they say, but the IOC under new President Jacques Rogge looks favorably on cities that make maximum use of existing facilities; some 80% of San Francisco's proposed venues are already built, vs. 60% for New York.

Then there is the athlete-friendly aspect to its bid. Besides Southern California, there may be no spot on earth where more Olympic hopefuls live and train than Northern California. And no bid in recent memory has a higher percentage of former Olympians taking an active role. About one in three mem-

bers of the Bay Area Organizing Committee's board—including gold medalists Peggy Fleming and Kerri Strug—competed in the Olympics. Even Anne Warner Cribbs, the organizing committee's CEO, collected a gold medal in Rome in 1960 as a 15-year-old swimmer.

Still, vibes are strong that New York will prevail. "If I had a lot of money, I'd bet right now on New York. It's almost a foregone conclusion," says Robert K. Barney, co-author of *Selling the Five Rings: The International Olympic Committee and the Rise of Olympic Commercialism*.

One unstated reason is that post-September 11 New York is the sentimental favorite. The tragedy awakened many to the true character of the city, Doctoroff says. "The rest of the world sees us in a different way than before September 11. They see the true face of New York City—the courage, resiliency, and patriotism." And in which other city, Doctoroff asks, is the Olympic spirit more alive? "More than any city on earth, New York is a city for people with dreams," he says.

Ironically, Dan's Big Dream for New York began eight years ago in New Jersey, when Doctoroff and pal Nathanson were at a World Cup soccer game between Italy and Bulgaria. As Doctoroff watched in wonder at the nationalist passion, a brainstorm struck.

Now, if New York lands its first-ever Olympics—and even if it doesn't—the impact on Doctoroff, a 44-year-old millionaire, will be profound. Since he began mulling a New York Olympics, Doctoroff has turned his life upside down

DANIEL DOCTOROFF

UNDERSTAND me.

UNLEASH me.

UBER me.



YEARS Grew up in the Bronx, New York; attended St. Ann's Episcopal School in Newburgh, N.Y.; graduated from St. Ann's in 1968.

EDUCATION Harvard University, 1970-74; University of Michigan Law School, 1974-77.

NOTABLE JOB Deputy Mayor of New York City; Managing Director, Oak Hill Capital Partners, 1987-2001; Managing Director, Lehman Brothers, 1984-87.

SPORTS Played organized basketball, baseball, hockey, and football. Gridiron career ended as a high school freshman when he was injured three times in five weeks. Now, he rides his wife's mountain bike 6.5 miles from home to City Hall twice a week.

TURNING POINT Attending an Italy-Bulgaria World Cup soccer game in 1994, Doctoroff was so impressed with the fans' nationalistic fervor that he decided to launch New York's bid for the 2012 Summer Games.

FAMILY Wife, Alisa; one son, two daughters.

stepped squarely into the limelight. Last December, New York Mayor Michael Bloomberg tapped him as deputy mayor for economic development and rebuilding, a job that includes overseeing the sensitive and highly public process of planning a new World Trade Center site. Before starting in the post, Doctoroff cut his ties with Oak Hill Capital Partners Inc., a private equity investment firm formed with Texas investor Robert M. Bass, where he had been managing partner for 14 years. He also stepped down as president of NYC2012, a nonprofit group he set up to plan the New York Games—though he remains chief spokesman. Doctoroff's job is grueling (13-hour days are common), and the pay couldn't

be worse (he takes only a dollar a year). But as one of the mayor's trusted aides, Doctoroff, who met Bloomberg while courting him for the board of NYC2012, has become a player in city politics. That has set some wondering if citizen Doctoroff will someday be candidate Doctoroff. "It wouldn't surprise me even a little," says an associate.

Such talk makes Doctoroff noticeably uneasy. "None," he replies when asked if he has ambitions to run for office. "I'm focused on immediate goals." Clearly, the 2012 Summer Games top that list. Doctoroff's meticulous planning and relentless cheerleading have taken New York far—farther than Cincinnati, Dallas, Houston, L.A., Tampa, and Washington, all of which

AMD me.

Sports Business

failed to make the USOC's short list. But even if New York gets the nod, the heaviest lifting may be yet to come. Winning over the fickle IOC means prevailing in a pitched battle with cities such as Paris and Toronto. Both have been passed over recently for the Summer Games, and historically that gives them an edge the next time around.

So far, though, Doctoroff has proved adept at keeping New York in the game. With their eye-popping Olympic proposal, NYC2012 officials started early to head off doubts that a New York Olympics would be a logistical black hole. For instance, Doctoroff shares the credit for a clever transportation plan that would use high-speed ferries criss-crossing New York waterways to zip athletes to and from events. "Dan really captured my attention with that one. He's a master in terms of pulling together these complicated issues," says Seymour Sternberg, CEO of New York Life Insurance Co., which has contributed \$250,000 to NYC2012.

Doctoroff also has answers for how to pay for a New York Olympics, which likely would be the costliest ever. NYC2012 officials estimate that the price tag would be some \$3.3 billion, which would be covered entirely by TV rights, sponsorships, and ticket sales. Not tallied in that estimate is as much as \$5 billion for related redevelopment projects—a bill that would be mostly borne by private investors, says Doctoroff. That includes two of the Games' big-ticket items—a sprawling Olympic Village of 4,400 apartments that would be converted to upscale housing after the three-week Games and a massive facelift of Manhattan's West Side, including an Olympic Stadium.

Redeveloping the West Side figures to be controversial. Under the NYC2012 plan, the 86,000-seat stadium would be an annex to the Javits Convention Cen-

ter and the home of the New York Jets. The Jets ownership "basically will pay for the cost of the stadium," Doctoroff notes, minus the price of a retractable roof for conventions.

Some West Side residents aren't impressed. They fear a sports stadium will tear the fabric of



COAST RIVAL

Cribbs (left) is pushing Frisco. A New York promo image after September 11

Clinton—also known as Hell's Kitchen—an area of relatively inexpensive housing, affordable eateries, and small businesses. "Dan's a terrific guy. But if the stadium were taken off the table, things would go much more smoothly," says state Senator Thomas K. Duane, whose district includes Clinton.

Doctoroff says he understands the reservations. But in the next breath, he's stumping for urban renewal. "This is New York. Of course somebody's going to say it's not a good idea," he says. Doctoroff takes solace in advice given to him by former Mayor Rudy Giuliani, an early and enthusiastic backer of NYC2012. "You haven't been in public life before," Doctoroff says Giuliani told him when they first met to discuss Olympic plans. "You should understand that you'd be criticized if you gave away \$100 bills in Times Square."



It was good counsel for someone who had experienced little of the rough tumble of the public arena. Growing up in Birmingham, Mich., Doctoroff roes played for the local sports team. A devoted baseball fan, he still can't come off the name and position of each player on the 1968 World Champion Detroit Tigers. "I have a good memory of garbage," he jokes. Until he got married, Doctoroff concedes, attending a World Series game at Tiger Stadium with his late father, Martin, a state appeals Court judge in Michigan, was a highlight of my life."

Doctoroff went to public high school then Harvard and the University of Chicago law school. When his first wife, Alisa, came to New York to accept a job in 1983, Doctoroff joined her, grudgingly. "I found New York big and intimidating, [and] to be candid, boring," he concedes.

That seems eons ago, however. Doctoroff can't imagine living anywhere else. Or seeing the Olympic flame anywhere but the city's gleaming Olympic Stadium in 2012. "Obviously I'm optimistic," he says. Still, New York can't come soon enough.

By Mark Hyman in New York

Already On the Short List for 2012

Even if the U.S. Olympic Committee chooses New York over San Francisco to be the American entry in the contest to host the 2012 Summer Games, the Big Apple will still face formidable competition

CITY

PARIS

Advantage: It was passed over for the 2008 Summer Games (awarded to Beijing). There's little doubt among IOC members that the city has the venues, transportation, and scenery to pull off a successful Olympics.



TORONTO

Also on the IOC's A-list. A world-class city that meets all the requirements. Its fate may rest on whether Vancouver nabs the 2010 Winter Olympics. No way Canada gets back-to-back Games.



RIO DE JANEIRO

Would be the first South American Olympics. Rio will host the 2007 Pan American Games, so the IOC will get a chance to see if the city is ready for the big time.



OTHER POSSIBLE CANDIDATES: Rome, Madrid

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work harder. I want
to work smarter.

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CHIPS

NO NERD AT THE TOP? HERESY!

Intel's CEO-in-waiting, Paul Otellini, is a master marketer

As a teenager, Paul S. Otellini set up an elaborate pulley system from a cliff in the Sierras so that he, his brother, and a cousin could drop right into Lake Tahoe. The pulley worked smoothly. But Otellini didn't factor in his weight. A few feet in the air, the rope snapped, and Otellini landed on the rocky shore, fortunate to escape injury.

Clearly no engineer, Otellini was sensible enough to pursue a career in sales and marketing. Yet in January, the 52-year-old exec was appointed president and chief operating officer of an engineering powerhouse, Intel Corp. He will share power with

CEO Craig R. Barrett until Barrett retires in the next two years. Then, Otellini is expected to become the fifth CEO in the giant chipmaker's 34-year history—and the first with no degree in engineering.

His climb to the top signals new challenges for Intel. Otellini will lead the chipmaker into a host of new markets, from cell phones to telecommunications

transmitters. Breaking into those segments requires every bit as much marketing savvy as engineering. **OTELLINI:** Not a bare-knuckled manager

And Otellini, while soft-spoken, has proven a master marketer. With the "Intel Inside" slogan in 1991, he guided what has been one of high-tech's most successful branding efforts. Indeed, marketing helped to transform Intel chips, long a hidden cog of the machine, into the ballyhooed brains of the PC. "It has come of age from having accomplished so much," says Intel Chairman Andrew S. Grove.

A 28-year veteran of the company, Otellini has long been the velvet glove over the fist employed by Barrett and taskmaster Grove, Intel's former CEO. Otellini, by contrast, doesn't issue edicts. Instead, he prods employees to think up solutions.

The question is whether Otellini, v

OTELLINI'S CHALLENGES

GROWTH

With PC sales slowing, Otellini needs to foster growth in chips for communications and wireless.

BALANCING PRIORITIES

Business is sluggish, but closing plants could be dicey when demand picks up.

GROOM NEW LEADERS

The executive suite is aging. A top priority is identifying and developing a new generation of managers.

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his low-key style, can lead Intel through one of the biggest makeovers in the company's history. After failed efforts in consumer electronics and running Web operations for other companies, Intel is focusing on its core strength, making tiny slices of silicon to power everything from handheld computers to telecom gear. Under Barrett's tenure, Intel has spent \$12 billion on 50 companies to win a foothold in these markets.

If Intel fails to drive up sales and earnings in the next two years, Otellini could well face pressure to back off from Barrett's plan. The numbers are grim. On Oct. 15, the company reported revenue for the third quarter ended Sept. 28 was flat year over year, at \$6.5 billion. Lehman Brothers Inc. expects 2002 revenues to fall to \$26.3 billion, down 1% from 2001's weak \$26.5 billion. Intel did post earnings of \$686 million, up from \$106 million last year. But Lehman predicts 2002 earnings of \$3.2 billion, a 13% drop from \$3.7 billion last year. Today Intel's stock hovering around \$15, near its 52-week low. Already, the company is cutting capital spending to \$4.7 billion, down from the original \$5.5 billion target. If the economy worsens, the chipmaker may face its third round of layoffs in the past two years.

For growth, Otellini will lean heavily on his marketing smarts. He'll have to convince skeptics that newcomer Intel has the chops to be a major player in industries now dominated by the likes of Texas Instruments, Sony, and others. Otellini says Intel has a winning proposition. By squeezing more functions onto a single chip, for instance, Intel vows to simplify phone and handset manufacturing. This should allow manufacturers to keep lowering prices—a must in maturing markets where customers need to be enticed to buy.

Otellini also has some ground to make up. He will have to tackle bad publicity surrounding the initial launch of Intel's Itanium server chip. Four years late, the high-end chip has been slow to gain customer acceptance, in part because Intel developed cheaper chips that were faster than the more expensive Itanium.

He has had plenty of time to hone his management skills. As a young executive sent to manage Intel's Folsom (Calif.) plant in 1987, Otellini had to deal with two unrelated employee suicides within a short spell that shook workers. In a company where execs scoff at touchy-feely sentiments, colleagues still recall Otellini's deft touch. He set aside time to talk to employees and brought in

counselors. It was then that Grove began grooming Otellini for larger roles.

A strict Catholic upbringing and working-class roots helped shape Otellini's management style. Deeply religious, his father David pointed his two sons toward the Church. Otellini's brother, Steven, became a priest and is a Monsignor at a Kentfield (Calif.) Catholic prep school. "Paul's very methodical and has a clear idea of what he wants—always trying to have fun doing it," he says.

In college, Otellini studied economics at the Jesuit-run University of San Fran-

PAUL S. OTELLINI

BORN Oct. 12, 1950, San Francisco

EDUCATION University of San Francisco, BA in economics, 1972; University of California at Berkeley, MBA, 1974

FIRST BIG RISK Broke arm in grammar school performing double back flip off a San Francisco pier at low tide.

CAREER Joined Intel in 1974.

Career took off in 1989 after becoming technical assistant to then-CEO Andrew Grove. In 1996, named executive VP, heading up processors for PCs and servers. In January, became fifth president, the first without an engineering background.

BIGGEST PROFESSIONAL CRISIS The introduction of the first Pentium chip in 1994, which botched some math calculations. Initial attempts to play down the bug turned into a PR disaster.

FAMILY Married to Sandy Otellini, two teenage children.

HOBBIES Family goes boating and skiing at second home in the Sierras.

CULTURAL IDENTITY A third-generation Italian-American, with strong Catholic upbringing. Member of Catholic philanthropy group Knights of Malta, which helps the sick and poor.

cisco, while holding down jobs at a clothing store and in the purchasing department of a slaughterhouse. After getting his MBA at the University of California at Berkeley, he wanted to remain in the Bay Area and found "this really neat" new technology that was transforming the orchards and farms south of San Francisco into Silicon Valley. Indeed, Otellini loves San Francisco so much that shortly after buying a spread in tony

Los Altos Hills, he sold it to move family back to the city.

Today, Barrett and Otellini complement each other in the two-man executive suite. On the business side, Barrett crisscrosses the globe touring Intel's 12 factories; Otellini meets with foreign dignitaries and customers. Otellini has taken on much of the day-to-day operations, including setting quarterly budgets and strategy. "Look at me as sort of Mr. Outside. Look at Paul as Mr. Inside," Barrett says.

Their personalities are just as complementary. In his early years, Barrett carried a baseball bat into meetings to remind subordinates to stay on point. Salesman Otellini, with his Zen-like manner, challenges employees to stretch. Sandra K. Morris, Intel's chief information officer, recalls that in 1997 Otellini was in charge to connect the company to its customers via the Web. Morris was astounded when Otellini suggested setting an internal goal of doing \$1 billion in Web transactions within 12 months—a target that was easily hit. "He has this quiet way of conveying enthusiasm, and you get excited with him," she says.

Colleagues also note his deadpan sense of humor. Shortly after the introduction of the Pentium chip, word spread of a wildfire about a flaw that produced errors in complex calculations. Otellini struggled to calm angry clients—but managed to find humor in it. A former executive recalls him wading into meetings, joking, "So-and-so just kicked my ass on the phone. Pardon me if I don't sit down."

These days, Otellini is busy pushing a subtle change in Intel's marketing posture. Instead of assuring people that they need ever-faster chips, he wants Intel to offer chips that satisfy a variety of needs. The new Banias chip, for instance,

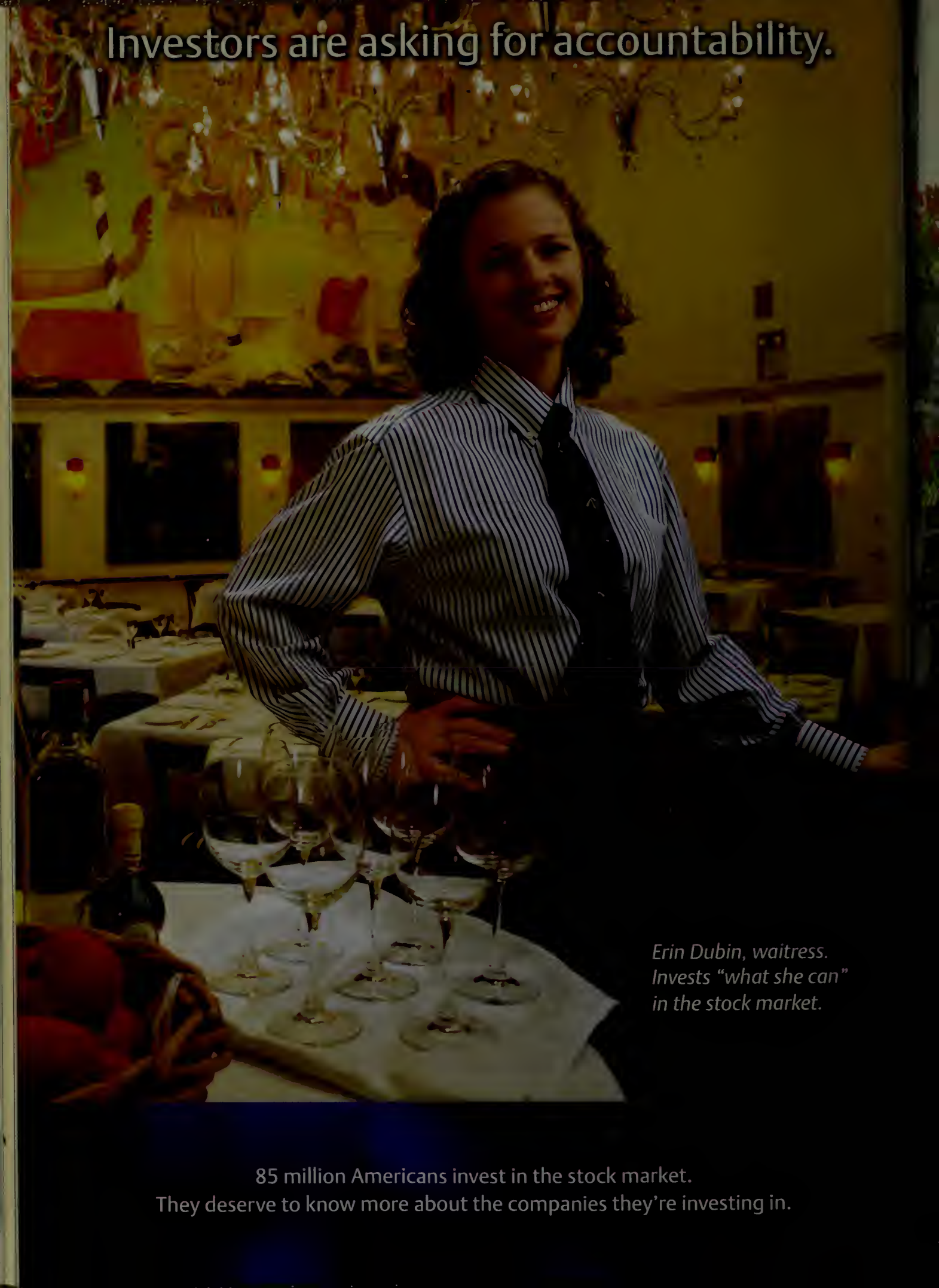
will be slower than Intel's current notebook chips, but it will include a built-in wireless modem, pack more memory and use less battery power.

His predecessors had fabled technical skills that built Intel into a chip giant. Now, Otellini has to prove that his marketing savvy can lead Intel into a new era of growth.

By Cliff Edwards
Santa Clara, Ca



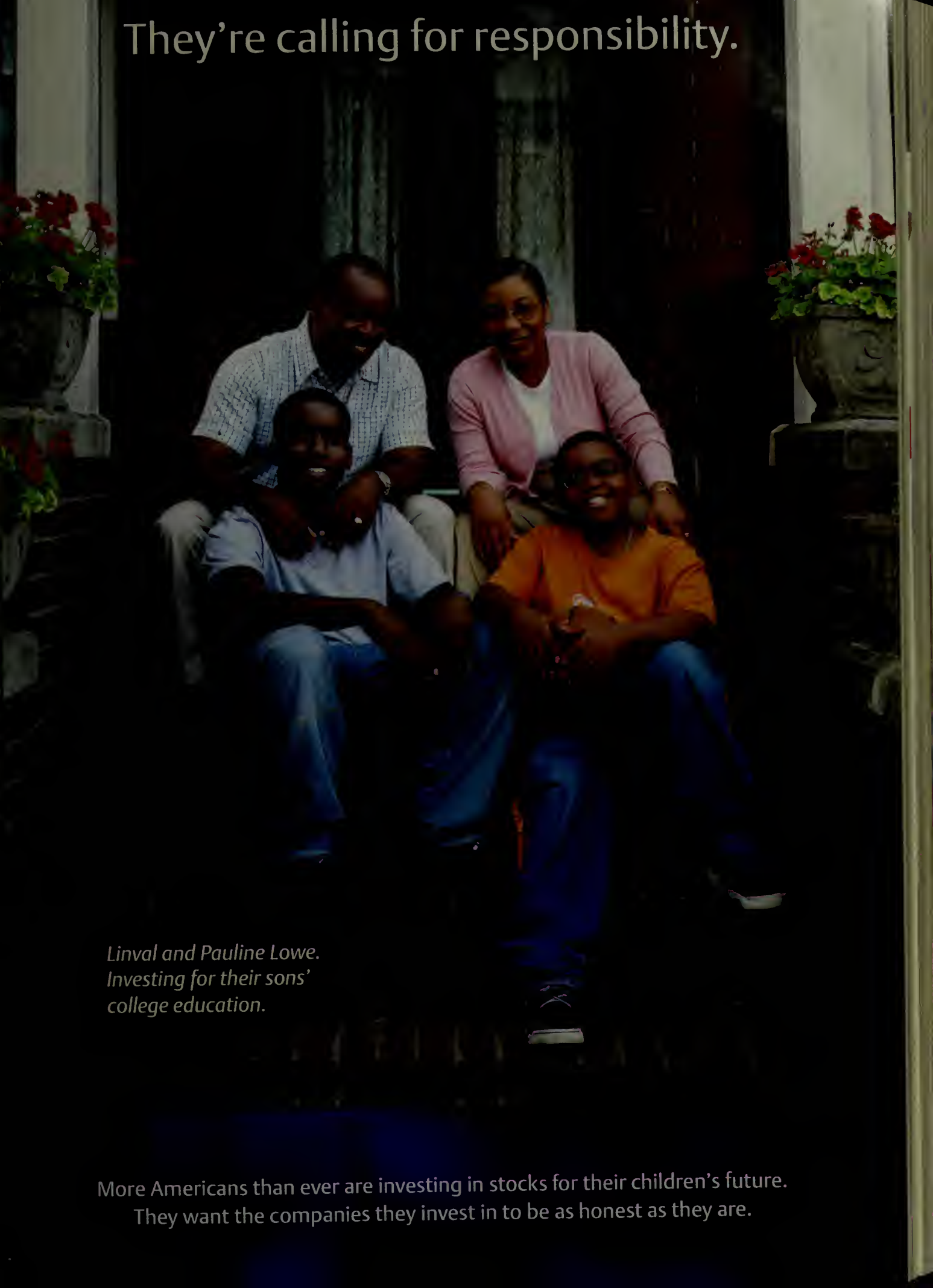
Hear that?

A photograph of a woman, Erin Dubin, who is a waitress. She is wearing a striped shirt and a dark vest, and she is smiling. She is standing behind a table that has several wine glasses on it. The background shows a restaurant interior with tables and chairs.

Investors are asking for accountability.

*Erin Dubin, waitress.
Invests "what she can"
in the stock market.*

85 million Americans invest in the stock market.
They deserve to know more about the companies they're investing in.

A photograph of a family of four sitting on a dark wooden porch. In the back row, a man with a beard and a woman are smiling. In the front row, two young boys are sitting, also smiling. The man is wearing a light blue patterned shirt, and the woman is wearing a pink cardigan. The boys are wearing blue jeans; one is in a light blue shirt and the other in an orange shirt. There are potted plants with red flowers on either side of the porch.

They're calling for responsibility.

*Linval and Pauline Lowe.
Investing for their sons'
college education.*

More Americans than ever are investing in stocks for their children's future.
They want the companies they invest in to be as honest as they are.

And they're demanding integrity.





*Woodrow and Hisayo Asai,
retired horticulturist
and school teacher.
Began saving for their
retirement 20 years ago.*

\$1.75 trillion is invested in 401k's.*
People need to know if their money will be there when they retire.



And

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mpa

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COMMENTARY

By Christopher Palmeri

BEFORE YOU REFORM WALL STREET, REFORM YOURSELVES

Besides trailblazing New York State Attorney General Eliot Spitzer, few local officials have been as vocal about the need for Wall Street reform as the three musteteers of state finance: New York State Comptroller H. Carl McCall, California Treasurer Philip Angelides, and North Carolina Treasurer Richard Moore. They've issued press releases, rallied colleagues in other states, and vowed to use the clout that comes from overseeing over \$200 billion in state funds to clean up the financial-services industry. Among other moves, they won't deal with brokerage firms that don't clearly separate investment-banking and research departments.

While wiping out conflicts of interest on Wall Street is certainly an admirable cause, there is one reform that McCall, Angelides, and Moore have yet to fully embrace—prohibiting state finance officials from accepting campaign money from individuals and firms with whom they do business. In fact, all three continue to receive significant funding from state contractors.

"I find it kind of surprising in the age of Enron and WorldCom that some issues have managed to slip under the radar screen," says Mercer Bullard, a University of Mississippi law professor and crusader for campaign reform. "The irony is pretty blatant."

Prohibiting such contributions is hardly a new idea. Outraged by so-called "pay-to-play" scandals in the early 1990s, the Municipal Securities Rulemaking Board, a quasi-governmental regulatory body, put severe limits on the ability of bond brokers to contribute to political campaigns in 1994. The Securities & Exchange Commission proposed a similar ban on contributions from money managers five years later, but after industry objections

and legal challenges, the idea went nowhere. The SEC says it has had other priorities.

Reform advocates suggest that the restrictions on bond brokers may have had the unintended effect of pushing pols to look elsewhere for contributions. Case in point: North Carolina Treasurer Moore. In early 2001, he changed his office's long-standing policy of using just one law firm for state work. He has also encouraged out-of-state contractors doing business with North Carolina to use local law firms. A spokesperson says Moore's decisions to give business to more than one firm and promote the use of local

firms are unrelated to campaign contributions. Still, lawyers are among his top contributors.

Angelides, who is on the 13-member board of the California Public Employees' Retirement System, has advocated investing more state pension money in venture capital, real estate, and private equity funds in California. The money managers who run such funds are among his top givers. Last November, for instance, CalPERS committed \$150 million to three groups managing affordable-housing investments. In the months immediately before and after that commitment, principals at those firms sent a total of \$75,000 to Angelides' campaign. A spokesperson says Angelides "casts his votes in the best interests of taxpayers and pensioners."

Comptroller McCall, the Democratic candidate for governor of New York, has received nearly \$800,000 over the past three years from firms that do business with his office. McCall has denied that the money influences his investment decisions as sole trustee of the \$112 billion New York State Common Retirement Fund.

Indeed, in a 1999 report calling for wide-ranging campaign-finance reforms, McCall endorsed a ban on contributions from anyone who does business with the office a candidate is seeking. But Steven Greenberg, McCall's communications director, says that since such a reform was never enacted, McCall "is not going to unilaterally disarm."

Few would argue with the efforts of the crusading trio to help clean up the Street. But it's hard to take them seriously when they at least appear to have conflicts of interest of their own. People in glass houses just don't make great reformers.

Correspondent Palmeri is based in Los Angeles.



DOUBLE STANDARD?

These public finance officials have criticized Wall Street for conflicts of interest even as they accept campaign cash from sources that do business with their states

H. CARL MCCALL The longtime New York State comptroller, who is running for governor, has accepted nearly \$800,000 from individuals and firms that do business with his office.

RICHARD MOORE The North Carolina treasurer has sought work for local lawyers, who are among his top contributors. He has raised almost \$400,000 from donors connected with the management of state funds and law firms involved in the underwriting of bonds over which his office has supervision.

PHILIP ANGELIDES The California treasurer has pushed for more state pension fund investments in private equity firms that have contributed \$300,000 to his campaign.

Date: BusinessWeek Democracy South

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Winning Workplaces

The winners of the sixth annual *BusinessWeek/Architectural Record Awards* comprise an extraordinary collection of architects and their clients who came together to create workplaces designed to promote innovation and creativity. In a corporate world obsessed with cost-cutting, architecture was used to reduce space, increase efficiency, and save money—without skimping on innovation.

Peruse the following pages, and you will find office space organized into “neighborhoods” to foster a sense of common enterprise; informal, flexible accommodations for meetings that stimulate impromptu collaboration; and great open bays of workstations, reflecting a flattened hierarchy. Most physical remnants of command-and-control bureaucracy are banished from these buildings.

Five of our eleven winners are corporate or university offices, and most of the others—from an automotive-parts plant in Mexico to Paul Brown Stadium in Cincinnati—were designed around their role as a workplace, whether for motor assemblers or football players.

We are very proud of this awards program,

sponsored by the American Institute of Architects in collaboration with *BusinessWeek* and *Architectural Record* (both publications of The McGraw-Hill Companies). It uniquely invites businesspeople as well as architects to judge how architectural solutions achieved measurable results in solving difficult business problems. Surely, to ac-

complish this while building outstanding structures represents an achievement worth heralding.

By Gerry Khermouch



The Cincinnati Bengals' Paul Brown Stadium

Bridge On The River Tyne



Newcastle and Gateshead are twin industrial cities in the North of England that face each other across the River Tyne. Long in the shadow of its neighbor, Gateshead needed to regenerate its rundown Tyneside district, boost its civic identity, and strengthen ties to its sister city.

The solution?

A striking new pedestrian bridge across the Tyne. The \$25 million structure is not only remarkably beautiful but also employs a distinctive method of tilting up to allow ships to pass un-

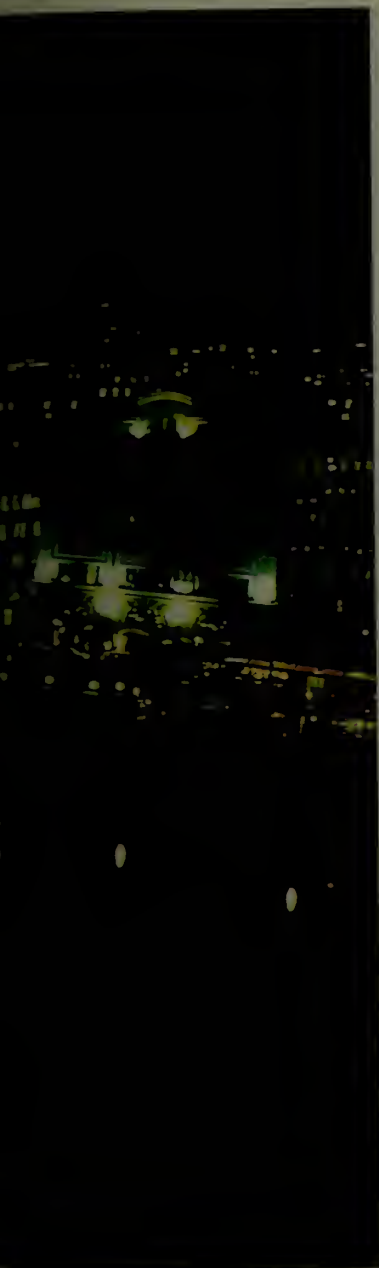
When the new footbridge tips to one side (right), ships can pass easily beneath



derneath. The bridge is comprised of a curved footpath and a high parabolic arch that intersect at their ends. When tall boats approach, the path simulates a 45-degree tilt, so that the metal arches both stand well above the water level.

Juror Chee Pearlman describes the bridge in these terms: "It's such a stunning sight in terms of engineering, and yet it's so simple. It's a simple motion, and yet it takes your breath away when you see it happen." Locals have taken to referring to the bridge as "the winking bridge."

With Tyneside's broader redevelopment just getting under way, it's difficult to quantify the success the bridge



side from a grain silo converted
ts center, there simply isn't
et to draw Newcastle's over.
o, the bridge's designers, Wilkin-
e Architects, note that "thou-
people currently cross each
spite a lack of any tangible
ion at the other side." With a
c music center due to open in
e next year, it could end up a
powded bridge.

HEAD MILLENNIUM BRIDGE
ad, England **CLIENT** Gateshead
ARCHITECT Wilkinson Eyre
ts, London **BUILDING TYPE**
an bridge

Clinical Improvement

In 1995, the pediatric group at Texas Children's Hospital realized its new outpatient facility wasn't cutting it. While some clinics were clamoring for more space, exam-room utilization was a paltry 41% overall. Poorly planned space was to blame.

A new building was planned to increase flexibility, offer a warmer welcome to apprehensive young patients, and enhance the institution's local image. Today, independent clinics share space on floors organized along the lines of a multi-use timeshare. The clinics are paired with a separate floor of offices that facilitates physicians' academic collaboration. Linking each pair: a two-story atrium dominated by a color-coded geometric shape that flags a play area for kids as well as the central patient check-in. Utilization rates are up, to 60%.

TEXAS CHILDREN'S HOSPITAL CLINICAL CARE CENTER

Houston **CLIENT** Texas Children's Hospital **ARCHITECT** FKP Architects, Houston
BUILDING TYPE Clinics for children



Vibrant atriums welcome young outpatients to Texas Children's Hospital

(RIGHT) PHOTOGRAPH BY HEDRICH BLESSING



Citified in the Country



A "treehouse" meeting room towers above the Ohio headquarters of Abercrombie & Fitch

Spun off from The Limited Inc., trendy retailer Abercrombie & Fitch Co. wanted to swap a drab, nearly windowless headquarters for a new space more in sync with its hip, urban image. It wanted to recruit young employees who epitomized its customers and build a place that would breed creativity and loyalty. The company wanted all this in rural Ohio—a dynamic city environment in a country setting. So it built a campus-like complex

aligned along a pedestrian "street" set among 300 acres of open fields, dense woodland, and streams. To foster communication and interaction among the employees, the buildings have indoor and outdoor fireplaces, expansive interior spaces, even a "treehouse" meeting room.



ABERCROMBIE & FITCH HQ

New Albany, Ohio **CLIENT** Abercrombie & Fitch
ARCHITECT Anderson Architects, New York
BUILDING TYPE Corporate offices

s 'R' Us Grabs a Starring Role on Broadway

mandate was straightforward enough. Beset by competing discount stores, Toys 'R' Us wanted to remind shoppers they still need a toys-only emporium and where better to get it than in that media capital of New York? The plan was simple—right in Times Square—national flagship store that would serve as a geographic and cultural destination for customers and toy makers. Toys 'R' Us did the job accomplished in 18 months just in time to catch the crucial holiday-shopping season in 2001.

Architectural firm Gensler and store-interior designer J. Newbold Associates, the retailer conjured a plan to convert two former theaters into a magic box that would exceed any existing expectations of a toy store. It would have huge interior spaces, a giant anima-



tronic dinosaur, and a 60-foot-tall Ferris wheel in the three-story atrium, with each car modeled on a different toy. It also would have an exterior skin consisting of 165 scrolling electronic panels to convey bold images, enabling the store to stand out amid the visual cacophony of Times Square.

The \$25 million investment is paying off: In less than six months, the store attracted more than 5 million visitors. Holiday-season sales significantly exceeded projections.

The store also has been candy to companies selling toys—Microsoft's Bill Gates paid a visit to launch Xbox—which have forked over millions to advertise on the building's electronic skin. Not least, the store-as-amusement-park is serving as a laboratory for the chain's hundreds of other stores.

TOYS 'R' US FLAGSHIP STORE

New York **CLIENT** Toys 'R' Us **ARCHITECT** Gensler, New York **BUILDING TYPE** Toy store

ew Laurels for an Ivy

Last year, the University of Pennsylvania won an award for deftly turning a chilled-water plant into a sculptural entry point to the campus. This year, it wins for transforming another mundane building, the Facilities & Real Estate Services Dept. The \$6 million project—18 months in design and construction—converted a 1929 railroad warehouse into a magnet for the university community in a remote section of the sprawling Philadelphia campus. The track level of the building was converted into a cluster of open-plan offices flooded with natural light, opening up to a new campus green intended as a focus of future development. Entry is through a concrete-and-steel building that frames the original loading dock and hoist assembly. The second floor is elevated to Walnut Street, while upper floors were converted to apartments. At \$100 per square foot, cost was half the university standard.

A bold makeover created a suite of open-plan offices at the University of Pennsylvania



IV. OF PENN. DEPT. OF FACILITIES & REAL ESTATE SERVICES

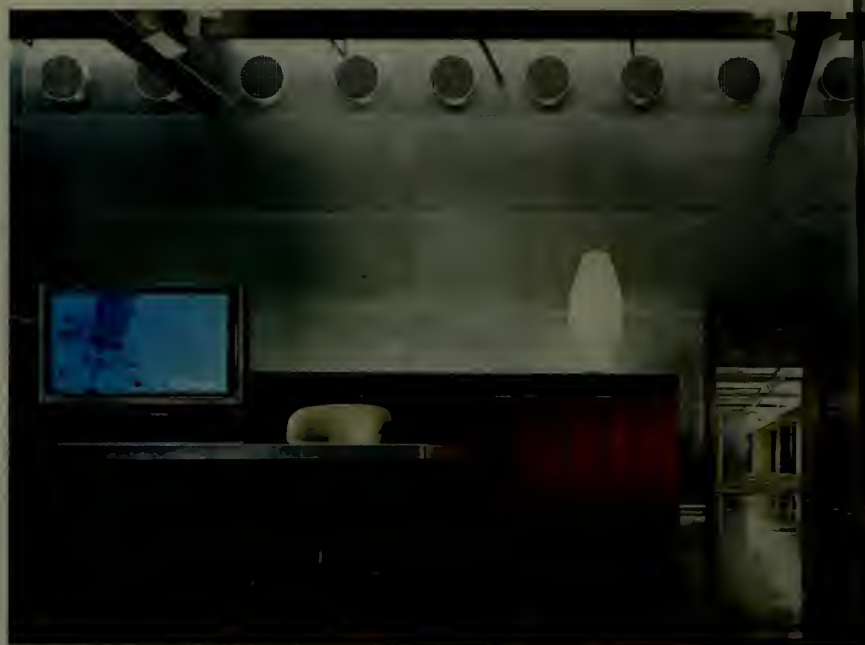
Philadelphia **CLIENT** Univ. of Pennsylvania **ARCHITECT** MGA Partners, Philadelphia **BUILDING TYPE** Offices for university's department of facilities and real estate

A Down-Home Office

Allsteel Inc. wanted to stress the brand's down-to-earth Midwestern values: warmth, modesty, and authenticity. So the office-furniture maker bought an abandoned 65,000-square-foot factory and decked it out with fireplaces, along with plenty of exposed concrete floors and ductwork. Working areas use the company's own furniture to serve as an "active showroom." Even the CEO sits in an Allsteel cubicle.

Business clients like it. After a year, corporate accounts have soared from a negligible 3% of sales to 15%. Thanks to stronger brand equity, All-

Allsteel's Iowa facility uses lots of concrete to convey Midwestern basic values



steel was able to raise its prices by 4%—at a time when most companies in the U.S. are cutting them. The new headquarters has generated closer collaboration among employees and has shortened the time for product development.

ALLSTEEL HQ

Muscatine, Iowa

CLIENT Allsteel

ARCHITECT Gensler, Chicago

BUILDING TYPE Manufacture corporate offices



CELLULAR OPERATIONS HQ

Swindon, U.K. **CLIENT** Cellular Operations
ARCHITECT Richard Hywel Evans Architecture & Design, London
BUILDING TYPE Corporate headquarters/call center

Swinging Cellular

When this project began, tech was still hot, and skilled workers were scarce. Cellular Operations Ltd., a British provider of cell-phone services, needed to get on the map—fast. An iconic building seemed one way of accomplishing this. The company erect-



Cellular Operations' glass headquarters is designed to entertain its young technologists

ed in Swindon a three-story glass structure where even mundane activities become visual theater. Ride the elevator, and a fountain moves up and down with the transparent cab. In the loo, cell phones are embedded clear plastic toilet seats. The purpose of the fun is clear. "A key part of motivating workers is creating a great environment," says juror Robert Vanech. "This is a great example of great, cool space." It seems to work: Turnover promptly dropped from 5% a year to 2.7%.



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DOOR-O-MATIC • GLYNN-JOHNSON • INTERFLEX • KRYPTONITE • STEELCRAFT

The Sum of Its Parts

Valeo, a French auto-parts maker, wanted its plant in San Luis Potosí, Mexico, to convey that it built sophisticated, highly engineered components and systems. It erected a column-free building using a modular, tensile exoskeleton. This created an uncommonly flexible one-story layout, suited both for reconfiguring manufacturing setups and for placing production, lab, and administrative areas close to each other. It also let Valeo build a structure 10% smaller than what was originally planned.



VALEO ELECTRICAL SYSTEMS PLANT

San Luis Potosí, Mexico **CLIENT** Valeo **ARCHITECT** Davis Brody Bond, New York **BUILDING TYPE** Auto-parts manufacturing plant

Touchdown

Sure, the 67,000-seat Paul Brown Stadium had to serve the needs of players and fans of the National Football League's Cincinnati Bengals. But the Bengals also wanted to make an architectural statement on the city waterfront. The solution was a stadium, more European in look than American, that departs sharply from the red-brick retro look so common today. Breaking up the seating bowl to eliminate corner seats with poor sight lines helped create a dramatic chiseled look.

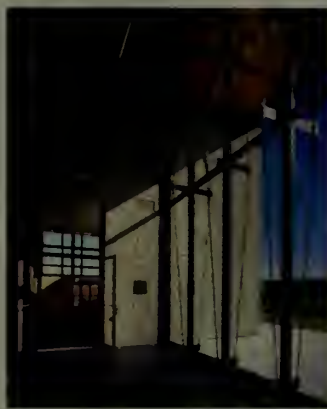


PAUL BROWN STADIUM

Cincinnati **CLIENT** Cincinnati Bengals **ARCHITECT** NBBJ, Marina del Rey, Calif. **BUILDING TYPE** Football stadium

Precisely the Right Image

Machine-tool builder Trumpf America wanted a customer center to showcase its equipment's capabilities: architectural elements, such as guardrails, made with gloss and precision. The new center's simplicity recalls the functional clarity of Mies van der Rohe. The metal-and-glass detailing lets Trumpf "achieve an amazing amount of concrete image and identity through a very abstract language," says juror Toshiko Mori. "It's a very sophisticated, intelligent project."



TRUMPF CUSTOMER AND TECHNOLOGY CENTER

Farmington, Conn. **CLIENT** Trumpf **ARCHITECT** Barkow Leibinger Architects, Berlin **BUILDING TYPE** Machine-tool builders' customer center

A Serious Playpen



This New Zealand project was designed to foster greater communication among a bank's call-center and information-systems employees. An open layout spreads businesses over five zones on three floors. A landscaped central "park," café, minigolf green, TV rooms, a

barbecue area draw people together. One hint that the workplace-as-playpen works: Interdepartmental e-mail dropped, a sign people may be talking more.

ASB BANK MULTI-USE CENTRE

Auckland, New Zealand **CLIENT** Dominion Funds Ltd. **ARCHITECT** JASMAX, Auckland, New Zealand **BUILDING TYPE** Single-tenant office building

BusinessWeek / Architectural Record Awards 2002 jury STEVEN M. GOLDBERG, Partner, Mitchell/Giurgola Architects, New York (jury chairman) LAWRENCE L. EDGE, President, World Development Federation, Norcross, Ga. MICHAEL HAMMER, President, Hammer & Co., Cambridge, Mass. JON ADAMS JERDE, Chairman/Founder, Jerde Partnership Inc., Venice, Calif. TOSHIKO MORI, Principal, Toshiko Mori Architect, New York TIMOTHY J. O'BRIEN, Vice President, Real Estate Development, Ford Motor Co., Dearborn, Mich. CHEE PEARLMAN, Chee Co., New York CATHY J. SIMON, Principal, SMWM (Simon Martin-Vegue Winkelstein Moris), San Francisco DAVID A. THURM, Vice President, Real Estate Development, New York Times Co., New York ROBERT W. VANECH, Venture Partner, AMP5 LLC, Santa Monica, Calif.



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ARCHITECTONICS, INC

Olympic Venture Partners Office Building is part of a transformation that is reshaping Kirkland's Market Street. Older, frequently substandard, residences give way to small office and professional services buildings. The existing street scene does not change significantly though. Land use and zoning regulations preserve the human scale of the street. This was one of the reasons OVP chose this new location for their offices. Moving from an anonymous corporate environment it was important for them that the new building have a unique character and at the same time be flexible enough to be customized. They also wanted the same high quality product they were accustomed to and one that did not look like an office building. Architectonics delivered a



The building is connected to the street allowing pedestrian access.

superb solution: an excellent design that catches the eye and provides business identity, and an open floor plan that allows custom room configuration. Taking advantage of Lake Washington views, the architects opened many

Kirkland, WA • 425.828.0329 • www.architectonics-inc.com



Market Street elevation provides business identity.

office spaces toward the southwest. The lush gardens and interior courtyard with water fountain create an atmosphere of tranquility. A special courtyard sculpture was designed and executed by Ukrainian sculptor Vasily Fedorouk. The stone was delivered from the same quarry that used to supply Michelangelo. The inspiration

for the sculpture came from a poem of a thirteenth century Islamic mystic – Rumi. The water in the fountain changes colors powered by fiberoptic light reflecting on the sculpture. The intricate wrought iron fence serves support for climbing plants. The architects took care of all the details there is sufficient parking in garage for employees and visitors. 21st century high-tech infrastructure that allows for internet based controls, and multi-zone climate systems that provide individual comfort for different parts of the office.

ARCHITECTONICS, INC.

Architectonics has been providing services to businesses and individuals in the Seattle area for over ten years. It specializes in small and mixed use buildings. Its strength lies in offering comprehensive services encompassing all stages of planning and construction.

ARUP

With strong roots as consulting engineers, Arup now plans, designs and project manages in the broadest sense. The company's 'total design' approach integrates the design and construction processes and all the professions involved with the creative nature of engineering design, the value of innovation and the social purpose of design. Innovation in design is often guided by problems that arise, and Arup's creativity in problem solving has earned it a reputation as the "Architect's Engineer". Arup helps translate architectural vision into a physical expression of its clients' goals, and has contributed to many Business Week Architectural Award-winning projects. Dedicated to delivering value, Arup currently operates out of 71 offices worldwide, with seven in North America: Boston, Detroit, Houston, Los Angeles, New York, San Francisco and Toronto.

Sun Microsystems, Newark, California: Architect: Kaplan McLaughlin Diaz / Bottom Duvivier Sun was rewarded with high post-occupancy employee satisfaction, despite the fast-track, cost-effective parameters of the new campus. In order to facilitate efficient management of the 11 month design, construction and occupancy time-



© Mert Carpenter Photography

frame, Arup implemented a project value system to analyze design decisions according to life cycle costs, productivity impacts and efficiency gains and benchmarked against construction costs. Key to the project's success: working interactively with the full design team.

San Francisco, CA • 415.957.9445 • www.arup.com



© Mark Luthringer Photography

Gap 901 Cherry Office Building San Bruno, California: Architect: Gensler / William McDonough Arup supported Gap's commitment to their employees and to the environment. Through elements such as extensive use of daylight and the thermally insulating native grass roof, the building can achieve 30% greater energy efficiency than required by state law. Arup's highly integrated building system design, configured under a raised floor, helps the company's pursuit of operational efficiency, by supporting varied occupancy levels and spatial functions throughout its evolving needs.

Wieden + Kennedy Headquarters Portland, Oregon: Architect: Allied Works Intent on establishing a creative environment, Wieden + Kennedy wanted the main atrium to be a versatile gathering space. Using 3d computer modeling to analyze the complex architectural details of the atrium, Arup developed



© Sally Schoolmaster

technology infrastructure optimized electronic projection options and architectural acoustics, while maintaining a desired clean aesthetic.

ARUP

UDSON GLOSS ARCHITECTS

ated on a steeply sloping lot
n magnificent views, our
nts were eager to maximize
panorama. A series of
cious decks, patios and
aces cascade from the rear
the house to present
many vistas.

trellis and an
ended porte-
here shelter the
hed stone entry
rustic wooden
or.

winding stair
ver climbs four
ries from the
kout lower level
the observation
creating interior
erlooks as well
extensive exterior
ws. The open
ir structure is

upported by 14"x14"x40'
umns reclaimed from the
h century Port Authority

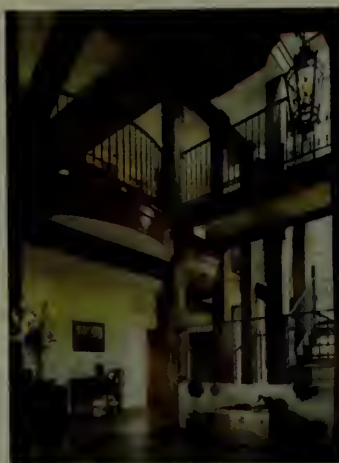
building in Vancouver. The treads
are a reddish brown mesquite
reclaimed from the University of
Texas. A 15-foot beam in the
guest suite was taken from a
1914 shipwreck. The extensive
use of natural stone, wood and



Situated on the 17th tee of The Ridge Golf course in Castle Pines, this extremely private setting has one of the most spectacular views along the Front Range.

interior water features mimics
the natural setting and integrates
the exterior and interior.

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The grand staircase spirals from the walk-out lower level to the 4th level tower room observation loft.

Avid entertainers, our clients
required flexible spaces. An
open floor plan, with room
separations defined by steps in
the ceiling and floor heights,
allows easy mingling for up
to 100 guests. The outdoor
terraces and decks provide
entertainment options and cre-
ate a sense of expansion and
spaciousness. An outdoor fire
pit affords three-season outdoor
entertaining. The 7,100 sf home
retains an intimate environment
for two with "human scaled"
rooms and many nooks and
reading alcoves.

kg

Knudson Gloss Architects are residential design experts specializing in the
creation of custom homes specific to the client's lifestyle, budget and
desires. Founded in 1977 and located in Boulder, CO, KGA has been
recognized for their work in a wide range of square footages and prices.

THE ALBERT GROUP ARCHITECTS

Station Valencia, a three-rink
na built in the midst of a
lthern California energy
es would seem at first a folly.
this folly is built on innova-
ideas and wisdom garnered

m decades of
signing around
challenges of
serts, draughts,
ergy crises and
quake faults.

Station Valencia,
igned by Stephen
ert, was endowed
n every techno-
ical advantage
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ld conceive of in
er to reduce it's
ergy consumption.

result: thirty-six
cent less energy
ed on the three rinks, than
ordinarily used on one
ndard rink.

The Albert Group, in conjunction
with Harold Orum the electrical,
mechanical and ice systems
engineer, has created a modern
wonder, a cool oasis in the heat.
The combination of Stephen



Ice Station Valencia, The entrance at night

Albert's graceful, community
orientated architecture that
takes advantage of every beam

Culver City, CA • 310.837.8863 • www.thealbertgrouparchitects.com



Inside, the NHL standard rink plays host to a wealth of community programs

of sunlight to cut down on
the need for electrical illumina-
tion and innovations in the
design of the ice systems has led
to a new thought process in
design and engineering.
In 2001 this innovation was
recognized with an award from
the Savings by Design Program,
who, in partnership with the AIA
has set out to; "recognize commer-



Ice Station Valencia looks out over spectacular views of the Santa Clarita Valley

cial projects that successfully
integrate architectural excel-
lence and energy efficient
design." In awarding Ice Station
Valencia both an AIA design
award and an award for energy
efficiency the jury concluded,
"the design team didn't overlook
anything in their energy-efficient
approach to enclosing a com-
plex function.

the albert group architects

THE LARSON GROUP, INC.

Travel up a winding path through pines and aspens to Sturman Industries' corporate headquarters, research and development and manufacturing facility and you'll get a sense that you're about to enter an alpine lodge.

As people enter the building across a covered bridge, they find a relaxed and beautiful environment. With craftsman influence, the building has expansive spaces and views, generous uses of wood, stone and natural lighting.

The Larson Group adhered to the Sturman's request to create a Colorado natural park and high tech lodge atmosphere.

"The project has been a major factor in establishing us in our industry. The surroundings, attention to detail, quality and inviting,

creative atmosphere has a power far beyond our expectations. Within minutes of experiencing the environment guests are disarmed, enchanted and impressed," said Carol Sturman, President.



Photography by Ed Lacasse

The building was designed to make employees and visitors feel like they are coming home. "Favorite places for employees to work are by the fireplace, at the sitting areas overlooking the peak, on patios, or walking through the nearby woods," Sturman said.

Colorado Springs, CO • 719.471.7676 • www.larsongroup.com



The campus is also a place that corporate leaders from around the world come to visit. "Upon visiting our facilities, corporate leaders from around the world are filled with excitement and enthusiasm for our company and the work we

do," Sturman said. "We have never experienced anything as special as this climate for performance that we have created. The Larson Group has successfully created the environment Sturman Industries originally envisioned by providing an comfortable, home-like environment that employees and

tors alike can appreciate. "A recent employee survey revealed 100% satisfaction with the building and corporate culture and its role in helping improve attitude, performance and productivity," Sturman said.

THE
LARSON
GROUP
A Professional
Corporation

Architecture
Planning
Interior Design
Construction
Management

ELLERBE BECKET

From the new Walt Disney Memorial Cancer Institute at Florida Hospital, Orlando, to the Comprehensive Outpatient Cancer Center at Wake Forest University/Baptist Medical Center in Winston-Salem, NC, health care providers are embracing

senses and support the full range of emotional, development, educational, and health care needs of patients and their families.

This approach is revealed in Ellerbe Becket's design for the new 60,000 square foot Crozer Regional Cancer Center, where conventional notions about the design of spaces for cancer treatment have been turned upside down, or in this case, inside out. Traditionally, the massive, windowless vaults containing the linear accelerators where patients are treated with high doses of radiation, are buried below



Crozer Regional Cancer Center

new design concepts in cancer treatment facilities. Ellerbe Becket has responded to these opportunities by creating facilities that appeal to all the human

ground. In the Crozer Regional Cancer Center, the vaults stand front and center where they become sculptural elements, and a backdrop for an interior



Crozer Regional Cancer Center

waterfall that links the public lobby with the private treatment spaces.

The striking, full-height glass façade makes real and "captured"

views of nature an integral part of the facility. Natural light and a bamboo garden in the waiting area provide positive reinforcement where patients need it most. Balconies projecting from the atrium on the upper floor where chemotherapy is provided offer a sense of openness while creating intimate spaces for contemplation or consultation. Connecting the radiation treatment and chemotherapy areas, the second floor is the Center for Integrative Health and Healing where specific spaces are provided for classes in nutritional counseling, massage, acupuncture, exercise, and the arts and stress management.

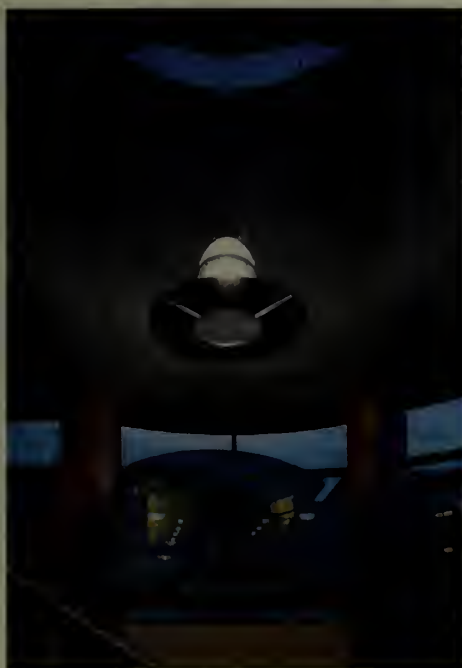
ELLERBE BECKET



An innovator since its founding in 1909, Ellerbe Becket is a leader in architecture, engineering and the construction industry with office locations worldwide.

H2A

H2A is people, process and projects: innovative organizations where ideas, design, and the latest technology converge to create provocative results within the science and technology markets. CUH2A listens, learns, and then acts. Its close relationships with their clients foster an exchange of ideas that yield compelling solutions that have kept our clients coming back for over 40 years. H2A's client base includes: Pfizer, AT&T, Harvard University, Pfizer & Gamble, Merck, The Centers for Disease Control & Prevention, and the National Institutes of Health.



Pfizer's Groton Campus

A full service architecture, engineering and planning firm, CUH2A has collaborated with Pfizer for over 20 years delivering built environments

that promote their energized business strategy. By carefully listening to key employees at various levels within their organization, and by learning and understanding their particular business goals, CUH2A has designed and implemented highly customized and creative solutions for Pfizer. Through an

iterative design process that rigorously responds to the individual requirements of a specific project—laboratories, offices, conferencing spaces and other amenities—CUH2A is dedicated to finding optimal design solutions. Together, the firm celebrates the power of vision that goes beyond their clients' expectations.



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OTAK ARCHITECTS, PC



entrance entry

In 2000, ODS Health Plans made a decision to decentralize a portion of its business groups in its downtown Portland, Oregon headquarters. A search for new sites revealed a former light manufacturing facility, then vacant and in disrepair. This presented the opportunity to not only relocate, but rejuvenate a property that was a visual and economic negative into a productive community asset.

Located in nearby Milwaukie, the four-acre site and its 50,000 sf building presented the design team with significant challenges. The shell, cast-in-place concrete with minimal fenestration, left the vast interior devoid of adequate natural light.

The interior concept organized the business groups along a central interior "street." Natural illumination was provided deep within the interior by six large light wells spaced along this street. The heavy timber roof structure was cleaned and restored. Independent elements within the open office plan serve as wayfinding devices and define workgroup areas. New materials differentiate old and new, contrasting smooth, refined finishes with rough and

weathered existing surfaces. Wherever possible, recycled, locally-supplied, and sustainably harvested materials were used. The existing concrete shell was cleaned and acid-stained to render it more like stone than poured concrete. The variegated ochre color contrasts with the highly-machined finish of the ano-

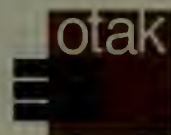


South elevation



Interior street

dized aluminum panels used to form all new exterior elements such as each building entry, lunch room extension, and loading dock area. ODS Plaza, recently awarded a "Governor's Livability Award," has been recognized nationally and locally as a project of significance and is a shining example of a physical resource transformed from neglect to a source of corporate and civic pride, as well as responsible and sustainable development.



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URS CORPORATION

Building Relationships As Well as Projects

URS doesn't just pursue jobs, they develop relationships with their clients. The company's 26,000 professional planners, architectural designers, engineers and construction specialists focus their knowledge and experience to design, build and complete projects that exceed the expectations of clients, which include more

than a third of America's Fortune 500. URS doesn't just understand the project, they understand the client and the client's business and put that knowledge into all the work they provide. This philosophy accounts for URS's long-standing relationships with some of the world's largest and most reputable companies and why, when they need to get the job done, they call on URS.



URS remodeled the 41,000 square foot facility on the University of Washington's campus in Seattle. The interiors feature highly stylized kiosk designs, for strong visual merchandising as well as energetic signage and changeable menu boards.

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The remodeled facility seats 1,000 and included new flooring with tile, terrazzo, art murals, modulated ceilings to create interest and state-of-the-art mechanical and electrical technology.

URS Serves Corporate America

Whether it's a state of the art executive aircraft operations center for NetJets, a 2 million sq. ft. automated air cargo dis-

tribution hub for the UPS Parcel Service or a polio technology laboratory for General Electric, URS has the resources to get the job done.

URS

ARCHITECTURAL NEXUS, INC. (THE MERGER OF JENSEN HASLEM & TPH ARCHITECTS)

Small Hospitals Prosper From Effective Design

It's tough for small hospitals to make it. Located in rural communities they provide similar services as primary care facilities in larger communities but lack the patient load to support it. Consequently, many small community hospitals are struggling to survive. Yet communities rely on them, especially for critical care. It is a dilemma facing thousands of rural communities.

A new concept in hospital planning is reversing this trend and allowing small hospitals not only to survive but to prosper.

Architectural Nexus, (formerly Jensen Haslem Architects) recently completed six small hospitals

in rural communities in Utah, Wyoming and Maine with others under way in Nevada and Colorado which demonstrate how proper facility planning is profitable to the hospitals and still yields attractive designs.

Juab County Hospital had a problem. Built in 1951, it was inefficient and poorly planned. Revenues were dropping and operating costs were rising. Rural Health Management Corp. in Nephi, Utah (pop. 5,200), managers of the hospital, questioned whether to remodel, build new or try to hold on. They hired Don Finlayson, leader of the Nexus health care design team who demonstrated how a new facility

utilizing efficient planning concepts would be the most effective solution. Mark Stoddard, CEO, said "**Our new hospital has been a great success.** Revenues are up 35% and costs have dropped. It is a beautiful facility that is profitable."

Bridgton Community Hospital, in Bridgton ME, (pop. 4,883) also needed a new hospital but could not afford it under traditional staffing models.

They heard about the success of the Nexus planning concepts through a colleague. By designing according to efficient staffing models, Architectural Nexus

created a beautiful facility. Bridgton is operating profitably. Since staffing costs account for 60% of a hospital's annual budget, designing a hospital around staff efficiency, operating costs of the hospital are reduced up to 40%.



Juab County Hospital - Nephi, Utah

Reducing costs, yet still providing effective care, is the hospital's balance sheet brought back to the black. So, more efficient hospitals can reduce en-

costs, maintenance and original construction costs as well. The surprise is that they can now afford to have a high quality and attractive facility. **Design pays.**



Bridgton Community Hospital - Bridgton, Maine

ARCHITECTURAL nexus

SA + ASSOCIATES ARCHITECTS INC

Established in 1989, Soga + Associates Architects Inc has provided innovative and client-responsive design solutions in the civic, affordable housing, retail, hospitality, commercial and athletic arenas of architectural practice. Some of their most challenging work has encouraged cre-

ates has touched tribes throughout the Western United States.

Inspired project design has incorporated not only Tribal trademarks and cultural sensitivity, but also larger issues of master planning and project management. Master planning has addressed long term visions of

Native American sovereign nations, providing inventive solutions to specific geographic and social requirements. Project management efforts have assisted Tribes successfully negotiate first-time partnerships with entities such as Hilton Hotels Corporation and the United

States Bureau of Land Management. Sometimes working in remote locations, their sensitivity to local ecosystems has been essential while incorporating cutting edge technology to



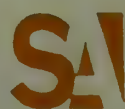
United States Forest Service and Bureau of Land Management Office Building - Working with the Bishop Paiute Tribe as the developer, this landmark project empowered that Tribe for further economic development

the design process and solutions. Environmentally sensitive "green" architecture has been a natural part of their design process with Tribal groups. Their respectful architecture not only addresses the materials and methods used in construction, but also represents itself in the operation of their projects.



The Elements, Win-River Casino - The introduction of high tech lighting, electrical, data and HVAC systems were necessary for the successful operation of this restaurant and overall casino facility.

Led by principals Clement Soga, AIA and Christine Witt-Ciffer, Soga + Associates Architects will continue to strive for "green" and socially responsible design solutions, empowering their clients with the ability to substantiate their vision, embrace their culture and respect their environment.



soga + associates
architecture ■ planning ■ interiors

BRERETON ARCHITECTS

Brereton Architects (BA) in San Francisco designed a new corporate headquarters for nationally recognized engineering firm Brown and Caldwell. Previously plagued by inefficiencies, outdated expansions, and poor circulation, the firm was relocating to a new 50,000 square foot office. Design included enhancing employee efficiency, increasing privacy in individual work areas, and providing access to shared resources. More challenging objectives

were to improve recruiting in a highly competitive engineering marketplace, and to stimulate employee interaction.

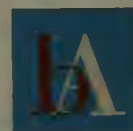
Applying urban planning principles, the firm turned departments into "neighborhoods" with workstations and resources clustered perpendicular to

exterior windows. This layout provided equal access to natural light and views and created "cul-de-sacs" where employee privacy has exceeded expectations. Spacious "boulevards" link these neighborhoods and contain shared resources and common areas. Highlighted by



colorful, angular walls, changes in ceiling heights, and thick, mullioned panes of glass, the boulevards create a sense of openness and activity. Natural light penetrates at boulevard intersections, used as location markers and informal meeting/working areas. Eventually these nodes will be

wired so employees can work away from their desks and cubicles. Was this design a success on all levels? Brown and Caldwell's CEO, Craig Goehring, gives a resounding yes. Work is completed efficiently and flows smoothly and non-disruptively from department to department. Employees are happy, and the firm is proud of its new space. In fact, Mr. Goehring recently received a call from the CEO of a competing firm asking to visit Brown and Caldwell's new office. It seems that one of his former employees said that he left to work with Brown and Caldwell because of their office.



San Francisco, CA • 415.546.1212 • www.brereton.com

Cover Story

By MICHAEL J. MANDEL

Profits are the lifeblood of a market economy. Without them, businesses don't invest, they don't spend on research and development, and they don't pour money into new products. Without profits, there's no incentive for innovation or for the creation of new companies. To a large extent, it was the incredible boom in profits during the 1990s that made that decade feel so vibrant. Record earnings per share, adjusted for inflation, more than doubled between 1993 and 2000. Federal Reserve Chairman Greenspan repeatedly pointed to higher profits as evidence that productivity growth had accelerated and that the U.S. economy had been transformed. Corporate executives used good earnings to justify

the process of boosting earnings is going to be far more difficult than most people expect, and it is going to entail far more pain for workers. Under mounting pressure from investors and corporate boards to get their earnings up—without accounting tricks—executives are going to have to make deep cuts in payrolls and productive capacity.

Part of the problem is that most companies are shooting for a return to the high profit levels of the late 1990s, which were never completely real in the first place. Back then, many companies were finagling their numbers to make the results seem better. What's more, a staggeringly large pool of profits was actually flowing out the door in the form of stock options, which were not figured into company earnings. *BusinessWeek* calculates that managers and workers at nonfinancial S&P 500 businesses took home more than \$100 billion in net proceeds from exercising stock options in 2000—enough to

The PAINFUL TRUTH About PROFITS

big investments in technology, while investors saw high profits as a sign to jump into the market. And it was the decline in profits in 2001 and the first half of 2002 that made the economy feel so depressed, despite growth in domestic product this year.

Now, corporate earnings seem to be coming back, compared with the very weak third quarter of 2001, and Wall Street strategists are predicting that the earnings rebound will continue into next year. Goldman, Sachs & Co. estimates that corporate operating profits in 2003 will rise by 12% to 14% above their 2002 levels. "We're not in a disaster scenario," says Tobias Levkovich, equity strategist at Salomon Smith Barney, who is forecasting a 7.7% rise in operating profits in 2003 for companies in the Standard & Poor's 500-stock index. But let's be blunt: Profits may very well rise next year—but it won't be a normal business recovery. The

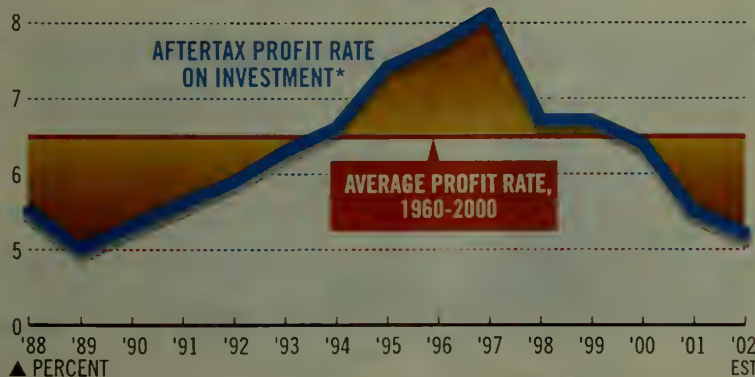
wipe out most of the increase in operating earnings from 1997 to 2000 (table, page 112).

And while corporate productivity gains have turned out to be real, higher productivity by itself does not guarantee higher profits in a competitive economy. U.S. corporations are 25% more productive than they were in 1992. But by the government's figures, the aftertax profit rate on corporate investment peaked in 1997. It likely stands at only 5.2% today, no

higher than it was a decade ago and well below the long-term historical average (chart). True, there are social gains from higher productivity—in the form of higher real wages and greater consumer spending power—but corporations get very little of it, according to William D. Nordhaus, an economist at Yale University who is examining the link between productivity and profits. Instead, "you just find prices falling more rapidly," he says.

That is further evidence the road to higher

THE PROFIT BOOM OF THE 1990s: HARD TO REPEAT?



profits will be a painful one. To meet their profit targets, companies will cut costs again and again, shuttering factories and offices and shedding unprofitable lines of business. The recent spate of layoff announcements from companies such as IBM, United Airlines, Schlumberger, and Sun Microsystems, as large as they are, is just the start. *BusinessWeek* estimates

Cover Story

that in order to boost operating profits by 12% during the next year, companies in the S&P 500 may have to cut some 900,000 jobs, or 4% of their workforce. That assumes revenues keep growing at the same sluggish 2% pace. Such a move would be the economic equivalent of an animal gnawing off its foot to get out of a trap. "There will be a price to pay for the earnings improvement," says George Magnus, chief economist for UBS Warburg.

The risk is that these massive layoffs could trigger a sort of growth recession in the U.S., the mirror image of the economy during the past couple of years. Rather than buoyant consumers and depressed executives, the environment is likely to sour for households even as business investment strengthens. A higher unemployment rate—perhaps topping 6%—would badly damage the housing and automotive markets, both of which depend on consumer willingness to borrow and spend. And the banks that lent heavily to consumers will see their default rates skyrocket. "We're going to be going through a tidal wave here," says Dean Baker, co-director of the Center for Economic & Policy Research in Washington.

What's worse, compared with the recovery of the early 1990s, companies today are facing much weaker global demand, greater overcapacity in many markets, and higher labor expenses. Export figures are at best flat, and all of the world's major industrial countries except Canada are expected to grow more sluggishly than the U.S. next year. Production capacity in manufacturing, already overbuilt, is still increasing, making corporations' pricing power nonexistent.

Above all, corporate labor costs are still 30% higher, nearly \$1 trillion more, than they were in 1997—despite a recession, slow growth, and weak profits. Surprisingly, labor costs continue to rise much faster than revenues, with real wages and benefits growing at a 2% rate during the past year.

In addition, the downward pressure on profits is taking place around the world. Profit rates in Britain, France, and Germany are far below where they were at the beginning of the 1990s. And while social-welfare laws make it harder for European companies to cut workers, layoffs are starting to come at companies such as Ericsson and Deutsche Bank.

How did we get stuck in this

tough spot? The main cause is a profound misunderstanding of the relationship between productivity and profits. Even from Alan Greenspan and Wall Street economists to chief executives and financial journalists made the assumption that higher productivity and new technology would inevitably translate into higher profits.

It's true that for any single company, higher productivity—that is, output per worker—will increase the profits, at least for a while. That's how innovative companies prosper. But neither theory nor history suggests that such gains should be sustainable over the long or even the medium term. Economists have long theorized that excess profits in a competitive market would be quickly eroded. For example, the textbook written by Robert H. Frank and Ben S. Bernanke, recently appointed a member of the Federal Reserve Board of Governors, says that markets in which businesses earn more than a "normal" profit will attract new entrants, driving down prices until those excess profits disappear. "When people confront an opportunity for gain," write Frank and Bernanke, "they are almost always quick to exploit it."

Sure, there were some problems when profits stayed strong. In the 1960s, productivity grew rapidly, and so did profits. But as U.S. companies took advantage of the lack of real global competition to boost their earnings in the 1920s—the decade that resembles the 1990s in its economic boom and exuberant market—the rapid growth in productivity did not lead to increases in profitability. The share of national income going to labor actually fell, from 9.7% in the 1920s to 8.2% in the 1990s. By the time the share of national income to labor soared as competition rose by some 40% in the 1990s, the 1920s.

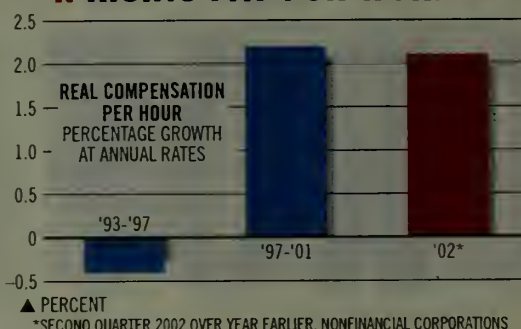
Still, there were plenty of people who believed that the boom of the 1990s was going to be different and they had a plausible argument. The idea was that the development of strong brand names, rapid technological progress, and the introduction of new products and services would enable companies to stay ahead of competitors. The exemplar was Intel Corp., which was able to keep margins up in a hypercompetitive chip market by investing heavily in research and development and new plants and repeatedly introducing new generations of faster, more powerful microprocessors at premium prices.

For a few years in the 1990s, Corporate America did indeed defy the somber predictions of economists and dramatically increased earnings. Starting around 1995, familiar names such as Coca-Cola, Procter & Gamble, 3M, General Motors, and Merck were reinvigorated, all enjoying skyrocketing profit growth over just a few short years. In 1997, Gillette

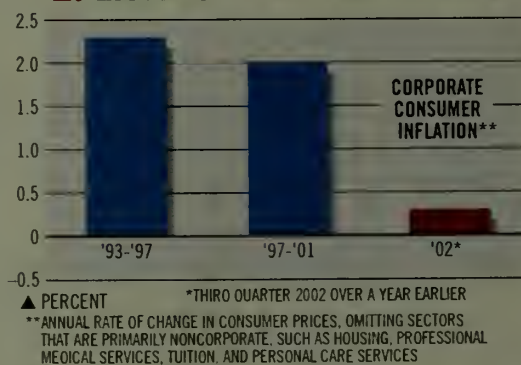
THE DRAG ON PROFITS

The same forces that held down U.S. corporate earnings in the second half of the 1990s are still active today

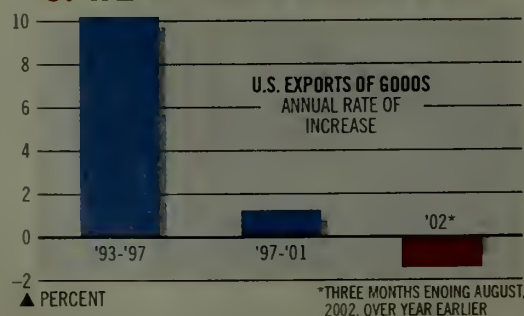
1. RISING PAY FOR WORKERS



2. LACK OF PRICING POWER



3. WEAK GLOBAL DEMAND



Qata: Bureau of Labor Statistics, *BusinessWeek*, U.S. Census Bureau



HIGH WAGES

After the recession and a year of slow growth, corporate costs are nearly \$1 trillion higher now than in 1997. Surprisingly, real wages and benefits continue to climb, rising at a 2% rate during the past year

ported net income of \$1.4 billion, five times its late 1980s level. Earnings per share at S&P 500 companies rose from \$22 in 1980 to almost \$40 in 1997, an 80% increase. The government's figures for corporate profits, which are based on tax-return data, increased by almost as much. Soaring profits helped to justify the ever-rising stock prices and attracted ever higher levels of capital spending.

profits attracted a tremendous wave of new entrants, along with souped-up capital spending by the industry leaders. The rapid movement of ideas across national boundaries, aided by the Internet, accelerated the entry of competitors in Europe and Asia in industries such as semiconductors and software.

Compounding the profits problem was a dramatic acceleration in wages. In the first half of the 1990s, wage gains re-

There was a mood of remarkable confidence among CEOs that the gains would continue. In 1997, Walt Disney Co. announced record earnings of more than \$1.9 billion in 1997, four times what it had earned a decade earlier. "Our core Disney business [is] in remarkably healthy condition," wrote CEO Michael D. Eisner in his letter to shareholders in the 1997 annual report. It is "an era of tremendous success."

What made this economy-wide profit surge especially sweet was that it reversed 25 years of slow earnings growth and sliding profit margins. Earnings per share for the S&P 500, adjusted for inflation, had risen by only 6% between 1968 and 1993, even while the economy doubled in size. The aftertax rate of return on corporate investment, using government figures for profits, had fallen from an average of 7.8% in the 1960s to 7.0% in the 1970s—to only 4.7% in the 1980s.

But there was a problem: After 1997, technology improvements kept coming and productivity kept rising. Profits, however, did not. To be sure, companies reported that earnings per share for the S&P 500 jumped 26% from 1997 to 2000, while operating earnings rose by some 13%. Nevertheless, when government statisticians were at last in a position to collate the tax-return data for those years, they found that profits for all corporations actually fell by 6% from 1997 to 2000, before dropping an additional 10% in the 2001 recession.

What happened? It turns out that the market economy operated much more efficiently than most observers had expected. In industries from telecommunications to retailing to consulting, those with the promise of good

Cover Story



►► SLOW GLOBAL GROWTH

Weak economies overseas have kept exports at best flat, and most major industrial countries are expected to grow more slowly than the U.S. in the coming year

remained relatively muted, enabling companies to pile up big profits. But after a lag of a couple of years, the labor market reacted to higher profits and faster growth just as economic theory would have predicted. Starting in 1996, as the unemployment rate dropped below 5.5% or so, wage growth began to speed up. Real hourly wages for production and non-supervisory workers, which had been falling since the early 1980s, finally began to rise. In this increasingly tight labor market, stock-option issuance surged as part of the compensation package for managers and other skilled workers.

Finally, lackluster economies overseas worsened the profits outlook. The aftermath of the 1997 Asian crisis, combined with

with \$5,000 in cash. In many cases, the company option buy back those shares and thereby effectively pays out \$5,000 in cash to the employee.

Figured this way, the effective wealth transfer from option was huge. Although the numbers for these net proceeds were not reported by most companies, *BusinessWeek* was able to estimate them based on data from annual reports. Look at what happened to Cisco Systems Inc. during this period: In fiscal year 1997, operating profits at Cisco, before tax, were \$2.1 billion and net proceeds from exercised stock options were between \$700 million and \$1 billion, according to our estimates. By 2000, the picture had reversed dramatically

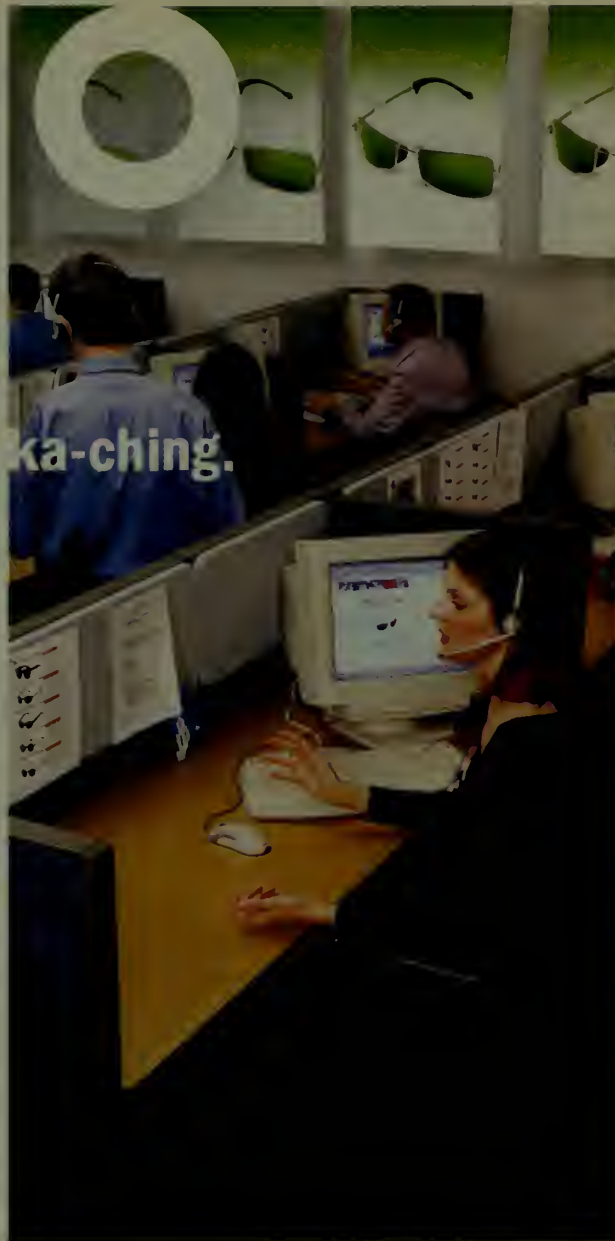
economic weakness in Japan and Germany, made it tough for corporations that relied on sales abroad. Exports had been growing at 10% annually until 1997, when growth came to a halt. Today, exports are higher than they were years ago.

Look no further than the published earnings figures of companies such as DuPont, Gillette, and Coca-Cola to see the impact: All reported sharply falling net income in 1997. Further, other companies obfuscated their decline. WorldCom and Enron engaged in accounting shenanigans to cover their acute problems. In 1997 to 2000, these two companies alone nearly quadrupled their level of reported operating profits, from \$1 billion to \$7.4 billion—a considerable chunk of which was probably overstated. In the tech sector, reported earnings did soar from 1997 to 2000, but misleadingly counting for stock options concealed a tremendous transfer of wealth from shareholders and companies to workers and managers.

There are different ways to measure the cost of stock options, including assigning a value to options at the time when they are granted. However, the simplest and the one used by government statisticians is to count the net proceeds from exercised stock options as payment by companies to employees. This method has the advantage of measuring cash going to workers. For example, if a manager exercises 100 stock options at a difference of \$50 between the market price and the exercise price and then sells the shares, he walks

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erating profits had risen to \$4.6 billion—but our estimates show that workers and executives got at least \$5 billion and likely as much as \$8 billion in proceeds from exercising options. The bottom line: Labor took away far more than the business was making.

Cisco is an extreme case. But because the overall stock market was so frothy in 2000, there were plenty of other companies where managers and workers took stock-option gains in excess of \$1 billion that year. By our calculations, the list includes such blue chips as General Electric, Dell Computer, Microsoft, Pfizer, and Intel, not to mention Yahoo! and Lucent Technologies. In 2000, Enron checked in with stock-option gains in excess of \$1 billion as well. Once these gains are subtracted from profits, as the government does and as companies do on their tax returns, much of the high reported profits melt away.

Not all the gains in the late '90s were illusory. In the financial sector, operating profits are up 24% since 1997. Earnings fell on Wall Street, but commercial banks have had spectacular success. They benefited from a combination of low interest rates and the consumer-spending boom, which boosted

credit-card usage and mortgage financing. In addition, financial-services outfits are the most intensive users of information technology outside the tech sector, which helped increase productivity.

Yet, even in banking there remain dangerous threats to profitability. For one, consumer lending will fall off if unemployment rises. Some analysts also argue that the banking profits during the past few years were built on aggressive lending. That could easily lead to more defaults if households find themselves stretched too thin. "Higher levels of risk will come back to bite them in 2003," cautions Michael Mayo, a banking analyst at Prudential Securities.

Perhaps most disturbing, labor costs at commercial banks are still rising at a rapid rate. These banks have actually added jobs over the course of the past year, and data from the Federal Deposit Insurance Corp. show salary and benefit payments rising at a 7% rate. As a result, as their earnings start to fall off, even banks will need to make sharp workforce cuts.

The same is true for the entire economy. While the unemployment rate has risen from a low of 3.9% in 2000 to the latest figure of 5.6% in September, it still hasn't been high enough to push down wages in most industries. The last time the unemployment rate was at this level for a sustained period was the first half of 1996—and that's when wage gains actually began to accelerate.

►► OVERBUILT

There's already an excess of U.S. industrial capacity, and more is on the way—making it almost impossible for corporations to raise prices

Moreover, much of the country is still enjoying unemployment rates well below the 1996 level. Despite the devastation in the tech sector, the September unemployment rate in California is only 6.3%, below the 7.2% average of 1996. Similar unemployment rates in New Jersey and New York are lower than they were in 1996, despite the terrorist attacks and the recession—in part because the banking and pharmaceutical sectors

remained strong.

Even as wages keep rising, companies still find it hard to raise prices. The latest figures from the Bureau of Labor Statistics show consumer prices up by over the past year. However, that estimates the buying power of companies, because it includes noncore sectors such as housing, medical, professional services, and education. If you exclude them, *BusinessWeek* calculates that the "core consumer price index" rose by 0.2% in the ending September. That's not enough to fuel profits.

And there's relief for profits coming from overseas demand. Japan, second-largest economy in the world, is still mired in long slump. Economic forecasters in Germany, the third largest economy, have recently lowered their forecasts for economic growth next year, from 2.4% to 1.4%. And while exports to China, one of the remaining bastions of global economic strength, have been rising, imports are growing even faster. As a result, the trade deficit with China is 20% during the past year.

The next couple years could be the ultimate test of flexibility of the U.S. economy. Businesses will need to make themselves for a world where profits are much harder to come by. Consumers will need to adjust to an economy where jobs are much more vulnerable and incomes less assured. Such is the hard truth about profits.

With Margaret Popper in New

HOW OPTIONS SAPPED PROFITS

Companies reported big profit gains from 1997 to 2000. Most of that increase went to workers and managers, who collected big gains on the proceeds by exercising stock options. These proceeds represent a real transfer of wealth: Typically, they count as taxable income for the recipient and are deducted from income on corporate tax returns.

	FISCAL YEAR 1997 (BIL.)	FISCAL YEAR 2000 (BIL.)	PERCENTAGE CHANGE
REPORTED OPERATING INCOME*	\$488	\$618	26.6%
ESTIMATED NET PROCEEDS OF EXERCISED STOCK OPTIONS**	30	115	283.3
PROFIT ADJUSTED FOR OPTIONS***	458	503	9.8
PROFIT ADJUSTED FOR OPTIONS AND INFLATION (2002 DOLLARS)	503	527	4.8

* After depreciation, but before taxes, for S&P 500 nonfinancial corporations

** Based on 40 large option-using corporations, plus a sample of the remaining S&P 500 nonfinancial companies. The net proceeds from exercised stock options are estimated by taking the difference between the average price of the stock over the fiscal year, minus the average exercise price as reported by the company, multiplied by the number of exercised options.

*** Reported operating income minus net stock option proceeds.

Data: Compustat, Bloomberg, *BusinessWeek*

Cover Story

Inevitably, many will confuse the all-new Accord with a highly refined European automobile. Fine. After all, the Accord EX V-6 now sports a 240-hp engine, a leather-trimmed interior with heated front seats and an available voice-activated navigation system.* Let the head scratching begin.

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CORPORATE ETHICS

WHAT DID PHIL KNOW?

Anschutz says he didn't notice the shenanigans at Qwest. So far, investigators aren't convinced

As a wildcatter in the 1960s, Philip F. Anschutz was known as a guy who could turn disaster to his advantage. Once, he collected fees from a Hollywood crew that wanted to film a well that had caught fire. Now, it's Anschutz' reputation that's ablaze, and the wily 62-year-old financier is working overtime to douse the flames.

Qwest Communications International Inc., the telecom he founded, is under investigation by the Securities & Exchange

Commission and the Justice Dept. for questionable accounting. Two class actions accuse Anschutz and other Qwest executives of securities fraud and mismanagement of company savings plans. On Sept. 30, Anschutz was accused in a lawsuit filed by New York State Attorney General Eliot Spitzer of "fraudulent and illegal acts" for steering Qwest's investment

banking business to Salomon Smith Barney in exchange for glowing research reports and pieces of lucrative stock offerings. Anschutz' spokesman James Monaghan called Spitzer's suit "unfounded and absolutely without merit."

Anschutz told House Energy & Commerce Committee investigators, who have been probing Qwest's accounting for months, that he was a ceremonial chair-

man who relied on executives and accountants for advice. That got him when the committee trotted out Qwest CEO Joseph Nacchio and other executives at an Oct. 1 hearing. But Nacchio testified he talked two or three a week with his former boss. "I made a major decision I made at this time sought his counsel," Nacchio said. "I got investigators interested in Anschutz again. 'If he didn't know what was on, why didn't he?'" says Ken Johnson, spokesperson for the House committee. "We all know falling asleep at the wheel can be fatal." The investigators plan to interview Anschutz again on Oct. 1 and decide if further action is needed.

What Anschutz knew and when he knew it have become crucial questions in the unraveling Qwest tangle. The time Sunday school teacher has a lot of supporters who attest to his honesty and integrity. "There are a lot of dishonest CEOs," says former U.S. Secretary of Education William J. Bennett, a consultant to one of the film companies Anschutz owns. "Phil Anschutz isn't one of them."

Anschutz told House investigators his sales of Qwest stock, totaling more than \$2 billion over the past four years, were made without any inside knowledge of the slide in Qwest's business and that he owned only 17% of his original holdings. Anschutz' one regret, sources close to him say, is that he let Qwest continue investing in telecom infrastructure—\$17 billion in 2000 and 2001—based on an overly optimistic growth projection.

But Anschutz is having a far tougher time explaining how a sophisticated investor whose holdings range from movie theaters to movie theaters didn't see the looming accounting scandal at the biggest single investment. Documents supplied by congressional investigators as well as interviews by *Business Week* with former Qwest executives and others reveal that Anschutz, who was co-

Qwest until June, may have had to suspect that its accounting was too aggressive. The first warning that something might be amiss was in a Morgan Stanley report of June 20, 2001. It suggested Qwest was inflating its earnings with maneuvers such as increasing the expected returns of its pension fund. Qwest reacted swiftly, sharply refuting the Morgan Stanley's accusations. Qwest ultimately cut the firm off from future investment banking work, according to testimony that Qwest's former chief financial officer Robin R. Szeliga, gave Congress. In a pattern that what would be repeated in the following months, Anschutz and the Qwest board relied on testimony from the company's senior management and auditor, Arthur Andersen. At the time, Anschutz family friend Jordan Haines, a retired banker from Wichita, defended the handling of the accounting issues. "I believed, and perhaps I shouldn't have, that we were getting the best advice available from Arthur Andersen," Haines says. Haines says he never discussed Qwest's accounting issues with Anschutz, who wasn't on the audit committee.

Anschutz's spokesman, Michael Hagan, says: "There is a methodology that Phil Anschutz was running Qwest single-handedly determined policy matters. In this there was a capable audit committee that was in constant dialog with management and Arthur Andersen on these issues. We had every reason to believe they were pursuing that diligently. It could have been wholly appropriate for Phil Anschutz or any other board member to circumvent the audit committee process."

But outsiders are skeptical. "A director has a duty to care, and care means asking the tough questions," says governance activist Nell Stew, co-founder of The Corporate Library LLC. "In my regard, Phil Anschutz didn't measure up."

In July 25, 2001, another Morgan Stanley report raised questions about the company's swaps of long-distance network capacity with other carriers in so-called indefeasible rights of use (IRU) deals. When, members of Qwest's senior staff had already be-

gun to complain to Szeliga about the swaps accounting. She sent a memo to her staff and Qwest President Afshin Mohebbi on Aug. 2, clarifying company policy.

In October, Szeliga learned that a \$109 million capacity swap with British giant Cable & Wireless PLC may have had an unusual side agreement which allowed the company to upgrade to another cable. Accounting rules required Qwest to sell a specific cable if it wanted to book revenue immediately. Szeliga told Congress on Sept. 24 of this year that she called for an audit-committee investigation of the transaction and alerted Nacchio and other executives. Szeliga testified that the audit committee concluded that the transaction was too small to merit a public restatement.

By October, 2001, debate about the company's accounting had become widespread. Press accounts that month highlighted an unusual transaction with a company called Calpoint LLC, in which Qwest sold telecom gear as part of a

long-term agreement for Calpoint to send business to Qwest. Qwest later acknowledged that the transaction is part of the SEC's current investigation. In a conference call at the time, Nacchio reiterated that Qwest's accounting was proper. A Qwest audit-committee investigation later supported that conclusion.

Where was Anschutz during all this? Mulling a big raise for Nacchio. Even as Qwest was laying off 4,000 workers because of its poor performance, Anschutz was sitting on Qwest's six-member compensation committee, which gave Nacchio a new five-year contract with a 40% hike in salary and bonus to \$5.2 million a year on Oct. 24, 2001. Nacchio also got options on more than 7 million Qwest shares. Nacchio told Congress this year he wanted to leave Qwest when his contract expired in December, 2001. Instead, Anschutz and others persuaded him to stay, with Anschutz calling Nacchio's wife to enlist her help.

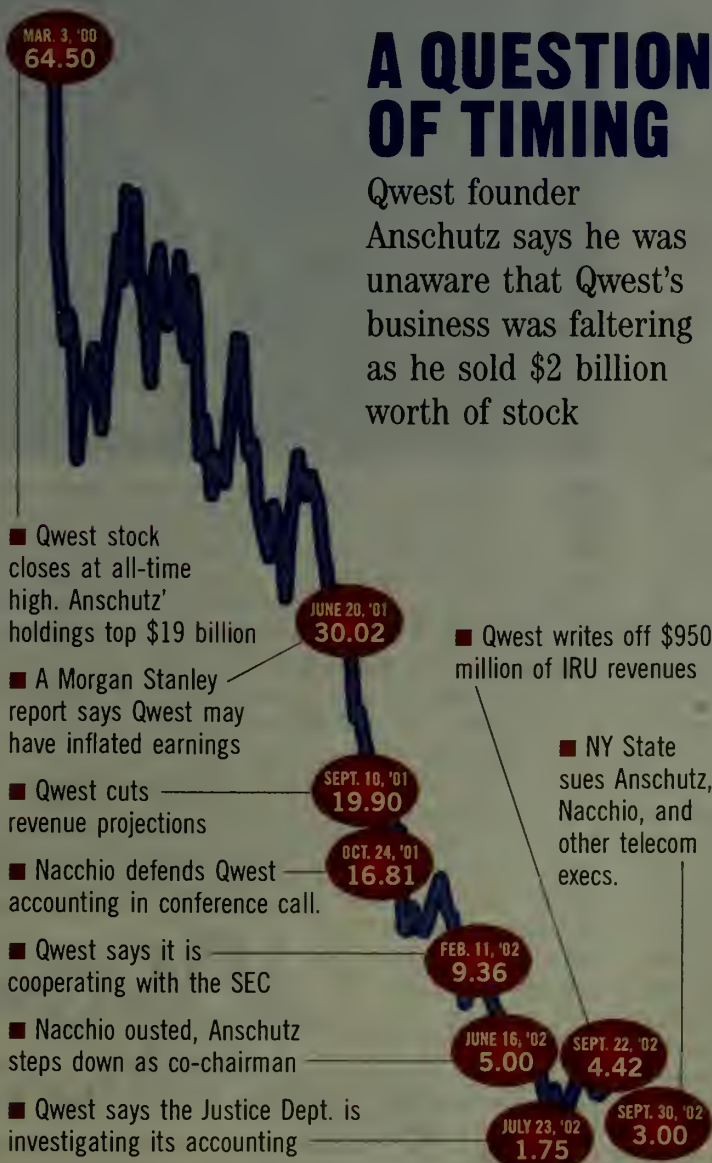
The raise is all the more surprising because it came a few weeks after an evaluation of Nacchio had been presented to a board meeting. In it, board members criticized him for not sufficiently "fostering legal and ethical conduct" and not keeping the board fully informed about what was going on at the company. The report also cited "accounting credibility issues" and a "make the numbers or else" attitude at Qwest. Nacchio told Congress on Oct. 1: "Mr. Anschutz manages the board. I stayed because the board asked me to. The overall evaluation was above average."

Longtime associates say Anschutz gives his top lieutenants unusual autonomy, which may be at the root of his current problems. "Phil is not a hands-on manager—he's a big-picture guy," says Jerry Davis, a former chief executive of Southern Pacific Rail Corp., which Anschutz controlled until 1996. Adds Douglas Hanson, Qwest's first CEO: "The day-to-day routine of running a business would drive Phil Anschutz nuts."

However, Anschutz, a business major at the University of Kansas, could easily have found out that Qwest's IRU accounting was among the most aggressive in the industry. According to Lynn E. Turner, the SEC's chief accountant at the time and now a professor of accounting at Colorado

A QUESTION OF TIMING

Qwest founder Anschutz says he was unaware that Qwest's business was faltering as he sold \$2 billion worth of stock



*Monday closing prices

Data: BusinessWeek, company reports, Yahoo! Finance

State University, other carriers booked such contracts over their life, of up to 25 years. But Qwest counted the entire sales and profit in the quarter the transactions closed. Moreover, Qwest's disclosure was scant. "They set themselves up to take a big fall," says Turner.

Sources close to Andersen say the lead Qwest auditor, Mark Iwan, reported to the audit committee on numerous occasions in the past three years his concerns about the IRUS. "Management and the board conceive, initiate, and structure business transactions and determine accounting policy, not the auditor," says Andersen spokesperson Patrick Dorton.

It wasn't until early February of this year that the Qwest board hired outside counsel to investigate Andersen's work, say sources. That was after publication of a letter from former Global Crossing Ltd. finance official Roy Olofson criticizing Global's capacity swaps with Qwest. Later that month, the SEC launched its investigation into Qwest. By May, Qwest's stock had slid to \$5 a share, down 90% from its March, 2000, high. Shareholders called for Nacchio's ouster at the company's annual meeting on June 3. Two weeks later, Anschutz flew to New York to tell Nacchio he was being replaced by industry veteran Richard C. Notebaert.

Now, Anschutz, too, has been pushed into the background. He's no longer even the ceremonial chairman, though he remains on the board and the largest shareholder with an 18% stake. The company is moving quickly to correct the damage. After consulting with the SEC over the summer, Qwest decided in late September to write off \$950 million in capacity sales on its network. In early October, Notebaert said the company was seeking to renegotiate \$2.5 billion in equipment-related deals, such as the one with Calpoint. Qwest declines to comment on the reasons for its restatement until it concludes the investigation of its accounting later this year.

Some former executives suggest Anschutz may be loyal to his managers to a fault. In the past, they say, he has held on to top execs long after they needed to be replaced. Such loyalty and his hands-off management style might have worked in a privately owned business. But in a public company such as Qwest, Phil Anschutz owed shareholders his loyalty as well. This is one blaze even an old wildcatter from Denver will find difficult to put out.

By Christopher Palmeri and Ronald Grover in Los Angeles, and Amy Borrus in Washington

ACQUISITIONS

CLOSED EYES, OPEN WALLET

How could Schwab have not known that U.S. Trust was a tech sinkhole?

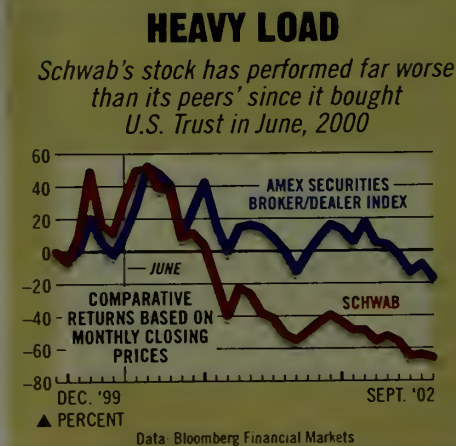
The news out of Charles Schwab & Co. has been bad lately, but mostly explainable. The voracious bear market has taken a big bite out of the discount broker's trading volume, revenues, and profits. But a look behind the recent management shakeup at U.S. Trust Corp.—the private bank Schwab bought in June, 2000, for \$2.7 billion—raises a more disquieting issue. In its eagerness to tap upscale markets and become more than the people's broker, did the normally savvy Schwab miss serious warning signs at U.S. Trust?

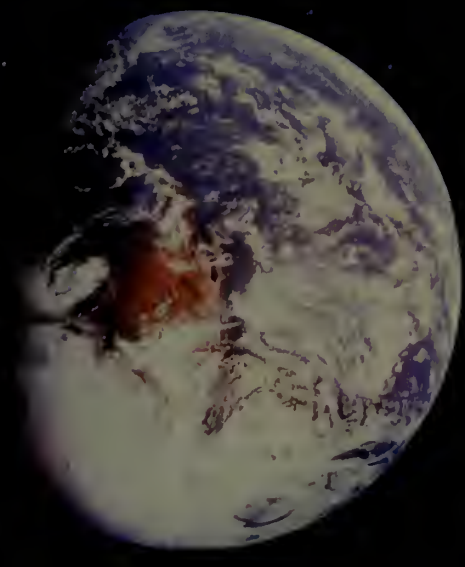
Schwab's bland Oct. 1 announcement gave little hint of the turmoil at 149-year-old U.S. Trust. Alan J. Weber, former chief fi-

nancial officer at insurer Aetna Inc., succeeded Jeffrey S. Maurer as CEO and replaced Maribeth S. Rahe as president. When Maurer would leave the firm, the release said, Maurer would remain on Schwab's executive committee. Everyone was graciously thanked. Weber and Maurer declined comment for this story, and Rahe declined to return a call to her home.

But Schwab executives concede they ran out of patience with the prize after paying 60% more than the market value of the deal close to mid-2000. "We needed to dramatize the change for operational improvements," says Schwab co-CEO David Pottruck.

Classic me





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problems dogged the union. U.S. Trust managers didn't cut costs fast enough. Longtime portfolio managers and private bankers left, taking clients with them. And the main hope for the acquisition—stopping Schwab's richest customers from defecting to full-service banks such as Merrill Lynch & Co.—hasn't panned out. Few Schwab customers have \$2 million in assets—the rock-bottom minimum for U.S. Trust's pricey hand-holding—and those who do tend to be do-it-yourselfers.

But the biggest shock has been U.S. Trust's outdated technology. Because its computers failed to detect suspicious patterns of cash transactions, the bank had to pay \$10 million in July, 2001, to settle charges by the New York State Banking Dept. and the Federal Reserve that it wasn't complying with anti-money-laundering rules.

(The bank didn't admit or deny fault.)

How could a company like Schwab, which built its reputation on its tech savvy, miss something so key? Former U.S. Trust employees say Schwab execs were dazzled by the glossy brand and pedigreed clients. Schwab says it inspected U.S. Trust's systems thoroughly. Regulators' prior reports hinted at problems, says Pottruck, but the woes seemed manageable. "We knew there were areas in need of improvement, but we had no idea it had that kind of material weakness." Since the discovery, "the enormous effort to remediate" U.S. Trust's compliance shortcomings has made it hard to address other issues, says Pottruck.

Weber, who has no direct experience in wealth management, will have to find a way to do so. Pottruck has known Weber since they both worked at Citibank. He says he hired Weber for his experience managing a business with many branches, as well as for his tech savvy. Weber supervised Citi's international offices, and his responsibilities at Aetna included tech operations and e-business.

Weber's first job will be to rally the bank's demoralized troops through another painful transition. U.S. Trust was largely owned by its employees, who received Schwab stock, which has since fallen 72%. Last year, U.S. Trust laid off people for the first time in memory, and key managers, including the heads of private banking and operations, left after the regulatory action.

Next, Weber will have to complete

the mammoth task of upgrading technology at a company that didn't even use the standard Windows operating system until the late 1990s. Among the remaining pieces of the tech puzzle: putting U.S. Trust's 30 branches onto a single computer system and improving

back-office operations, which cramped earnings since J.P. Morgan Chase & Co. stopped handling the function for the bank after the merger.

Weber's biggest challenge by far will be delivering the growth Schwab wanted so badly. The company was too optimistic about Schwab's referrals to U.S. Trust. "U.S. Trust is used to serving financial snobs," says a former U.S. Trust employee. "Schwab's high-end [clients] were not at that level. Imagine having a company refer clients to a subsidiary, then the subsidiary turns them down." That situation shows signs of improvement. The number of referrals slowed to 260 in the third quarter from 320 a year earlier. Schwab says that's in part because it's more discriminating about whom it sends to U.S. Trust. It also blames the tough market for eroding client wealth.

The compliance mess weighs on growth. Portfolio managers now perform exhaustive background checks, far beyond what's standard in the industry on potential and existing clients. They confirm all client information—from kids' birthdays to reasons for large withdrawals, former staffers. That eats up time that could be spent securing new business. Clients also bristle at the questioning and extra paperwork. A Schwab spokesman says the scrutiny isn't onerous.

Then there's cost-cutting, an area where former U.S. Trust execs dragged their feet—toward their ultimate downfall. They "were given a mandate to make changes, and those changes were not being made," says a former employee. "It's a cocoon they lived in." Weber is expected to close U.S. Trust's weakest offices.

For Schwab, getting all the clients out of U.S. Trust is imperative. The brokerage's September trading volumes were down 5% from a year ago. Nine-month income fell 11% year-on-year to \$188 million on revenues of \$1.5 billion. "The wild card is whether Schwab can transform a high-worth business from [one of] steady earnings growth to more dynamic earnings growth," says Wall Street analyst. Seems unlikely. Trying to turn it around hasn't been the ticket. Wealth it was supposed to be.

By Louise
in San Mateo, Calif.



A LACK OF TRUST

Schwab pushed out top brass at its upscale U.S. Trust unit after a series of woes:

TECH MORASS

After years of skimping on technology, U.S. Trust couldn't detect suspicious cash movements or aggregate portfolio managers' results to support its performance claims.

REGULATORY TROUBLE

Regulators hit U.S. Trust with a \$10 million fine and a cease-and-desist order for lax reporting of large cash transactions. Now, it screens clients so closely it alienates them.

POOR RESULTS

U.S. Trust's execs didn't consolidate its numerous bank charters or cut costs at offices outside New York, as Schwab had requested, so results disappointed.

TALENT DRAIN

Key bankers and money managers, along with their clients, have left since May, 2002, after their retention agreements expired.

Data: BusinessWeek

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HE COLLECTS BUTTERFLIES —AND COMPANIES

But after building UnitedHealth into a medical giant, can Bill McGuire keep it rolling?

When Bill McGuire and his high school basketball coach used to go fishing in the Gulf of Mexico off Galveston, Tex., it wasn't unusual for them to haul in catches of over 200 pounds. Rivals were amazed at how McGuire knew just where among the jetties to drop his lines. "He'd say: 'Can you smell that? The fish are right over there,' and we'd catch 'em," says ex-coach Bill Krueger.

That was 35 years ago. But since being named chairman and CEO of UnitedHealth Group Inc. in 1991, Dr. William W. McGuire, now a 54-year-old former pulmonologist, has continued to reel them in. Only this time, the catch has been companies. Now, after building UnitedHealth into the nation's biggest health-services company at \$25 billion a year in sales, McGuire's challenge is to manage his sprawling empire—including a recently snapped-up \$900-million-a-year prize, AmeriChoice—to keep up the momentum. Even he admits that the outfit's "clearly phenomenal" growth rate is bound to slow.

Already, UnitedHealth's reach is extraordinary—through health-benefits

plans used widely by Corporate America, drug benefits for seniors through the American Association of Retired Persons, and Medicaid programs for the poor. By buying and expanding some 30 or so niche players over the past dozen years, the company now counts more than 1 in 7 Americans, some 38 million in all, among its customers. And while transforming a \$605-million-a-year regional Minnesota-based HMO into a diversified behemoth, McGuire has given shareholders a 35-fold return on their investment (the stock trades around \$100) since he became boss.

But the waters he trawls have grown choppy. With consolidation among HMOs ebbing, there are fewer target companies to fuel UnitedHealth's rocket-like growth. Moreover, corporate customers that offer UnitedHealth's coverage to their employees are starting to groan under the cost. In 2003, for the fourth straight year, their health-care costs will rise at a double-digit rate. In that environment, it's not surprising that McGuire's pay is under fire—he collected \$58 million in cash and exercised stock options last year, and holds \$388 million in so-far untapped options. Even an old friend, Colorado cardiologist Dr. David I. Greenberg, says such largesse is "obscene" at a time when patients have to fight for reimbursements. McGuire admits he makes "a lot of money" but says shareholders have enjoyed

big gains along with him.

No question there. Earnings-per-share gains were 30% or better in each of the last 12 quarters, including a 58% rise in the three months ended Sept. 30. That outpaces the 46% gain reported by well-managed WellPoint Health Networks Inc. and the 9% rise expected at struggling Cigna. UnitedHealth can't sustain that torrid pace, though. McGuire concedes that after this year's 35% rise in net earnings, to about \$1.35 billion, next year's gain is likely to slow to 20% or less—figures that Wall Street analysts generally don't dispute. And he estimates that UnitedHealth's sustainable earnings pace afterward will be closer to 15% a year. Since acquisitions made in the past year account for only about 1% of 2002's sales—less than the 2% of expected revenues—deal making will become less important.

Still, McGuire will have to rely on some acquisitions to keep the growth chugging. With UnitedHealth's co-

WILLIAM W. MCGUIRE

BORN Apr. 15, 1948, Troy, N. Y.

EDUCATION BA with honors, University of Texas, 1970; MD with highest honors, University of Texas Medical Branch, 1974. Board-certified in internal

and pulmonary medicine.

CURRENT JOB Chairman and CEO of UnitedHealth Group since 1991.

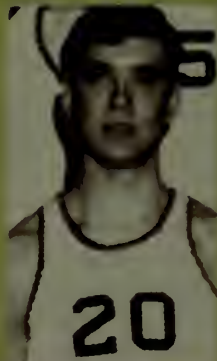
CAREER PATH Practicing physician in Colorado Springs, Colo., 1980-85, specializing in cardipulmonary

medicine. President and COO at Peak Health Plan in Colorado before joining UnitedHealth as executive vice-president in 1988.

TAKE-HOME PAY One of the highest-paid CEOs in the industry, with total earnings last

year of \$58 million, including \$50.49 million in exercised stock options. Holds an additional \$388 million in unexercised stock options.

HOBBIES Basketball star in high school (right). Now a world authority



on butterflies, including one species named

for him. Over the past few years, he has donated some 30,000 butterflies to the University of Florida as well as \$4.2 million to build the McGuire Center for Lepidoptera Research.

FAMILY He and his wife have two daughters.



ness largely consolidated, he is focusing a lot of his attention on faster-growing niche businesses, such as medical-administration services or long-term care for the elderly. Some of those areas are also riskier, more subject to swings in regulation or the economy. But McGuire says he can manage those risks through UnitedHealth's highly diversified structure. The company is divided into five separate operating divisions—including the UnitedHealthcare's conventional employer-based health plans, the Ovations group that treats older people for supplemental Medicare coverage and nursing-home care, and the Ingenix drug-development services for drugmakers—and some 20 separate business units. Inspired by Johnson & Johnson and other highly decentralized companies, McGuire is betting that some star divisions will do well enough to balance out the laggards. The \$16.2 billion UnitedHealthcare medical-services unit, the company's centerpiece, is a classic safe business with low margins—4.6% last year. On the other hand, the \$2.5 billion UnitedHealthcare pharmaceuticals unit, which provides health administrative services to large employ-

ers, boasts profit margins of 15.2% but is more vulnerable to corporate cost-cutting. "Everything is really a growth opportunity," says McGuire. "As we're [getting]

better at health care, we're ending up with more people living longer with chronic disease, complex disease. So I think the whole area of working on behalf of older Americans is a huge need, and accordingly a huge opportunity for us."

Despite the dealmaking, McGuire has always kept a keen eye on the end user. Unlike rivals, most UnitedHealth patients have long been able to see specialists without first going through primary-care physicians. And McGuire, who advises government and medical professionals about cancer through the prestigious Institute of Medicine's National Cancer Policy Board, saw to it that experimental therapies for breast cancer were covered. Such policies have won corporate business as employers and workers moved away from more

McGUIRE

Even he concedes that UnitedHealth's "clearly phenomenal" growth will slow

restrictive HMOs. UnitedHealth is "viewed as being one of the most patient-friendly companies out there," says industry critic Ron Pollack, executive director of Families USA.

McGuire has always been something of a maverick. Other insurers would not rush into a market its peers were fleeing. Yet that is what McGuire did in June, when UnitedHealth paid \$530 million in stock to buy \$900 million-a-year AmeriChoice Corp., a company that serves Medicaid recipients. Most rivals are deserting the government's insurance plan for the poor. McGuire is betting that the federal and state governments over time will more generously fund such programs—a long-shot wager, perhaps. Still, Donna E. Shalala, a UnitedHealth director who was President Clinton's Health & Human Services Secretary, argues that UnitedHealth can "produce a profit and be involved in producing high-quality service for vulnerable people."

Raised in a middle-class suburban Houston household, McGuire showed his taste for leadership early on. At 6'5" tall, he was the center—and the brains—of the successful (28-3) Clear Creek High School Wildcats basketball team in 1966, recalls Coach Krueger. After getting his MD summa cum laude from the University of Texas, he worked as a researcher at the Scripps Clinic & Research Foundation in California before moving to Colorado to practice cardio-pulmonary medicine. Then he joined an HMO as an executive, later becoming president. After it was acquired by UnitedHealth, McGuire began his rise to the top.

Even now, McGuire keeps up with science—in novel ways for an HMO chief. He is such a well-regarded expert on butterflies that lepidopterists named a newly discovered species after him, a brown central Texas insect now called *Euphyes mcguirei*. Along with a few million dollars, he donated his personal 30,000-insect collection to the University of Florida, where a research center will bear his name. Driven to upgrade the often highly varying care that doctors deliver, he has a company foundation twice a year distribute free to every U.S. doctor and many nurses copies of *Clinical Evidence*, a text of proven current medical practices.

McGuire's calculation: Better care for his 38 million customers will amount to an annuity for UnitedHealth. If he's to keep the company on track, that's an investment he'll need.

By Joseph Weber in
Minnetonka, Minn.



The megabillion-dollar cost of next-generation “fab” plants has the industry headed for a crunch

Every decade or so, the semiconductor industry goes through a wrenching metamorphosis that alters its very foundations. The industry is in the midst of such a shift today, and this one is the biggest ever. Its hallmark is a king-size silicon wafer—the silvery disk from which tiny chips are diced. Used for memory chips, just one disk’s worth could store roughly 5,000 sets of *Encyclopedia Britannica*. Or it could provide enough horsepower for a supercomputer. A few chipmakers are now processing thousands of these disks every day.

The new wafers measure 300 millimeters (12 inches) across, which may not seem like much of a jump from today’s

200-mm (8-in.) wafers. But the 50% increase in diameter yields 2.5 times more surface area for etching chips, yet costs only about 20% more to process. That will help ensure a continuing drop in chip prices for years to come—affecting prices for everything that depends on silicon.

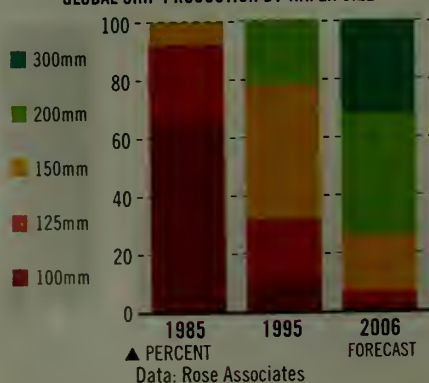
The most profound effect of 300-mm wafers, though, will be to reshuffle the chip industry’s worldwide balance of

power. And for all but the largest producers, the smartest choice may go “fabless,” avoiding the manufacturing rat race. The price of a chip fab or wafer fab, that can handle 30 platters can easily top \$2.5 billion—some plants are pushing past \$3 billion. Only a handful of traditional makers can justify such an investment because keeping one of “megafabs” humming requires annual sales of at least \$6 billion.

And yet, despite the semiconductor slump, many companies seem to be thumbing their noses at economic reality. By yearend, 15 megafabs will be under construction, including two from Intel and each from IBM and Infineon Technologies, plus several from contract manufacturers in Asia. Eight more huge plants are planned for next year. By 2007, as many as 50 megafabs may be up and running, with a combined capacity of 575,000 wafers a month. That’s twice the projected worldwide demand, even after the chip industry recovers from its current downturn.

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'This isn't going to be a polite kind of high-tech revolution—it's going to be the French kind'

calculates Morris Chang, chairman of Taiwan Semiconductor Manufacturing Co. (TSMC). So the stage is set for a bloody battle. "This isn't going to be a polite kind of high-tech revolution—it's going to be the French kind," predicts G. Dan Hutcheson, president of market watcher VLSI Research Inc.

Anticipating the bloodbath, many of the industry's Old Guard are holding off on 300 mm. For chipmakers such as Agere Systems (formerly Lucent Microelectronics), Fujitsu, and Toshiba, the stakes in this poker game are just too rich. In 2000, the best-ever year for chip sales, only 10 companies had sales in the \$6 billion range. Motorola Inc. made the \$6 billion cut back then—but not last year, when sales fell below \$5 billion. Thus, when Fred A. Shlapak, president of Mo-

big winner. Last year, the island nation's foundries processed about one-fifth of all the wafers carved into chips, according to Semiconductor Equipment & Materials International (SEMI), a Silicon Valley trade association. TSMC ac-

Sales of chipmaking gear have meted, so equipment makers can afford to develop tools that will tomorrow's thinner circuit lines on 200- and 300-mm disks. "Most vendors chose to support 300-mm wafers," P. Larry Tolson, head of wafer fabrication at Texas Instruments Inc.

But for a while, at least, 200-mm can buy new tools. Coming next year, these will trim line

the most advanced from 130 nanometers to a mere 90 nm, or the width of a human hair. Individual chips then shrink, more than be diced from a wafer, and chip yields would fall still further.

By late decade, however, 200-mm fabs won't be able to keep up with the technology—or supply chips for the most sophisticated products. Circuit lines will shrink to 65 nm, perhaps by 2005 and then to 45 nm before de-

end. With lines that skinny, a piped-size chip could be crammed with more computing power than Intel's latest Pentium 4 microprocessor, and thumb-size chips could sport a billion transistors. Those chips will be dirt cheap because each 300-mm disk will yield thousands

THE PAYOFF IN BIG WAFERS

Over the next five years, many chipmakers will start mass-producing semiconductors on king-size 300-mm wafers. Here are the trade-offs and benefits:

BIGGER WAFERS ARE EXPENSIVE...

**DIAMETER
SURFACE AREA**

200 MM
7.9 IN.
31,400 MM²
48.7 IN²

\$75

\$300

...AND COST MORE TO PROCESS...

COST OF CLEAN-ROOM EQUIPMENT

200 MM
\$1.4 BILLION
300 MM
\$2 BILLION

FINAL COST PER WAFER

200 MM
\$5,500
300 MM
\$8,000

torola's semiconductor unit, first eyed a financial analysis of 300-mm fab ownership, his reaction was a swift "Uh-uh. No way am I going to be stuck with one of those babies in the next downturn."

So most industry veterans are being forced to hatch a new business model. Of the Old Guard, only Intel, IBM, Texas Instruments, and Samsung are actually operating a 300-mm plant. The others are either collaborating on joint-venture fabs or turning to contract chip manufacturers, called foundries, for up to 50% of their future production. Some chip stalwarts doubt they'll ever build another new factory on their own.

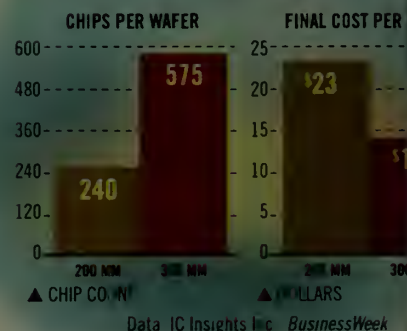
Because Taiwan dominates the foundry business, it's emerging as the

counted for half of that volume, and Chang predicts that Taiwanese foundries will process 40% of the world's wafers by 2010. Meanwhile, hoping to emulate Taiwan's success, China, Malaysia, and Singapore plan to build 15 wafer fabs, five of them 300-mm behemoths destined to serve as foundries. As a result, SEMI expects foundries, located mainly in Southeast Asia, to be churning out half of all chips by decade's end.

While some existing 200-mm fabs will continue in production for a decade, they'll have a virtual cap on revenues. If any market served by a 200-mm producer gets large enough to attract a 300-mm rival, "bang—the game is over," says Trevor Yancey, vice-president for technology at market researcher IC Insights Inc. "A 200-mm producer simply can't compete on price." Since building a new 300-mm fab won't be feasible for midsize producers, Yancey adds, "the only real choice may be to go fabless"—farming out production to a foundry.

In addition, 200-mm fabs will be increasingly confined to yesterday's low-margin processing technology. Blame that on the ongoing market slump.

...BUT SAVINGS ARE SUBSTANTIAL



them. And new applications will emerge. It might be economical, for example, to embed voice-activated cell phones in the tops of ballpoint pens.

With that many transistors packed with on each chip, designers will be able to create electronic gizmos that are only one piece of silicon. The mul-

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'In many cases,' says a former wafer honcho at IBM, 'you can do better, financially, without a fab'

lyhooded system-on-a-chip should arrive at long last. The bad news: Companies that make auxiliary chips—to speed graphics or control peripheral devices, for example—may need a new game plan. That includes most of the 50-odd midsize chipmakers in the U.S., such as Cypress Semiconductor, Fairchild, National Semiconductor, and Siliconix.

Systems on a chip could give a boost

of the 300-mm market. The soaring cost of factories has triggered a "tectonic shift" in economics, Sanders explained shortly before handing the CEO reins to Hector de J. Ruiz, former president of Motorola's semiconductor unit.

To compete in microprocessors with archrival Intel, AMD needs to tap the economics of 300-mm wafers. So AMD partnered this year with Taiwan's UMC

budgeting 20% of revenues for capital spending, we'll spend just 10%," Motorola's Shlapak, who dubs the strategy "asset-light."

Indeed, collaborations now permeate the industry because every facet of making next-generation chips is becoming too complex for one company to manage. Perfecting design methodologies and matching process recipes

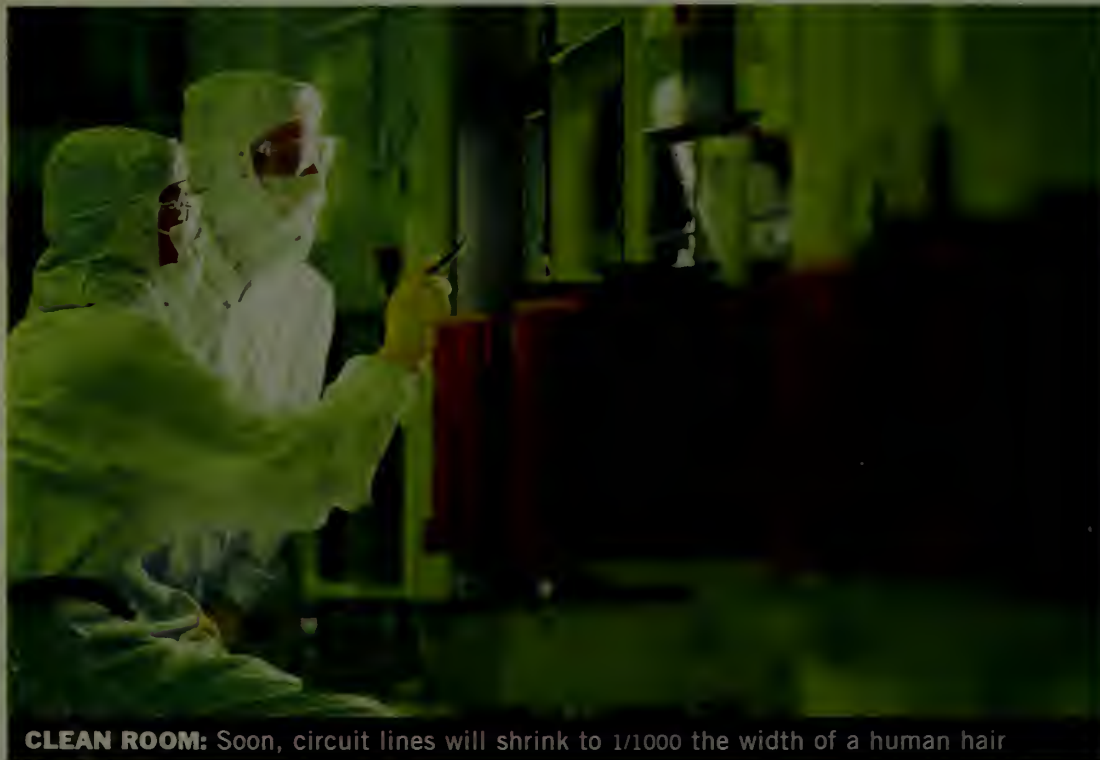
to circuit lines smaller than 100 nanometers can run into the hundreds of millions of dollars. That's what a Sony-Toshiba linkup expects to spend to develop the chip for Sony Corp.'s PlayStation. Faced with massive outlays, most chipmakers are staking out specialist positions and forming partnerships to share the financial burden.

Chipmakers that don't find some way to step up to the 300-mm plate understate their risks. They point to what happened to Japan's semiconductor industry. In the 1970s and '80s, the Japanese were hammering their American and European rivals. By 1986, Japan emerged as the world's leading producer of chips. But then, the Japanese delayed spending on the metamorphosis that

transformed wafers from 150 mm to 200 mm diameter. Sensing an opening, the Europeans, and Korea quickly jumped to 200-mm technology. By 1996, the Japanese had reclaimed the lead. Samsung Electronics blossomed into the world's biggest supplier of commodity microprocessors. And Europe's silicon industry couped its market-share losses. Today, when it comes to chips, Japan is a pale shadow of its former self. Clearly, says VLSI's Hutcheson, "size matters."

The jump to 300-mm wafers presents a stark choice. Companies that invest in the technology may not survive as independent producers much after 2005. And those that don't invest in it may find profits even longer. For many, going fabless may be the most sensible option.

By Otis Port in New York, with M. Kunii in Tokyo, Bruce Einhorn in Hong Kong, and Andrew Park in Seoul



CLEAN ROOM: Soon, circuit lines will shrink to 1/1000 the width of a human hair

to the fabless camp. Last year, four fabless companies posted sales above \$1 billion, led by Qualcomm Inc., with \$1.24 billion. And industry consultant Paul P. Castrucci, former head of IBM's 200-mm wafer fab in Vermont, says the advent of foundries actually makes outright fab ownership moot: "In many cases, you can do better, financially, without a fab."

But at least for now, few chipmakers are ready to give up their fabs. To old-line producers, a fabless semiconductor company has always been something of an aberration. "Real men have fabs" is the oft-repeated put-down from the 1980s by W.J. "Jerry" Sanders III, founder of Advanced Micro Devices Inc.

Even before Sanders stepped down as CEO early this year, he was rethinking that position. His new outlook is tantamount to "real men have fab partners"—a stance certain to catch on among others who have been priced out

of the 300-mm market. The Group and Germany's Infineon, formerly Siemens Semiconductors. Hutcheson of VLSI Research thinks AMD has picked the right partners. He credits Infineon with "doing more than any other company to make the 300-mm transition happen." Infineon cut the ribbon on the first 300-mm pilot line back in 1998. Now, Infineon and AMD are bartering their design and process expertise for 50% stakes in the twin 300-mm factories UMC is building in Singapore. The first, UMC/Infineon, is due to open early next year, and the plant next door—run by a partnership called AU, from the initials of AMD and UMC—will come onstream in 2005. All three are cooperating on process-development work.

Motorola, Philips, STMicroelectronics, and Taiwan Semiconductor have a similar arrangement. Their 300-mm factory in Crolles, France, began dicing up the big wafers earlier this year. "Instead of

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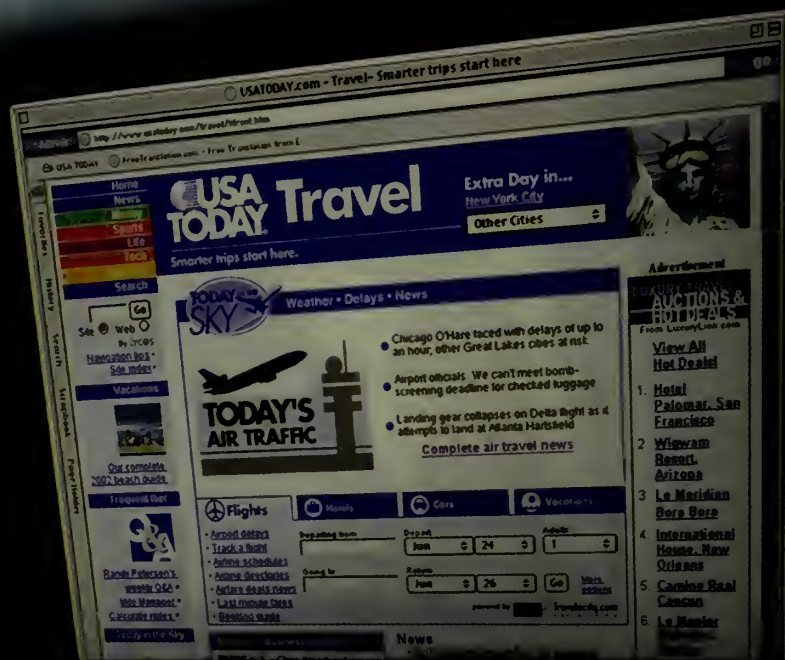
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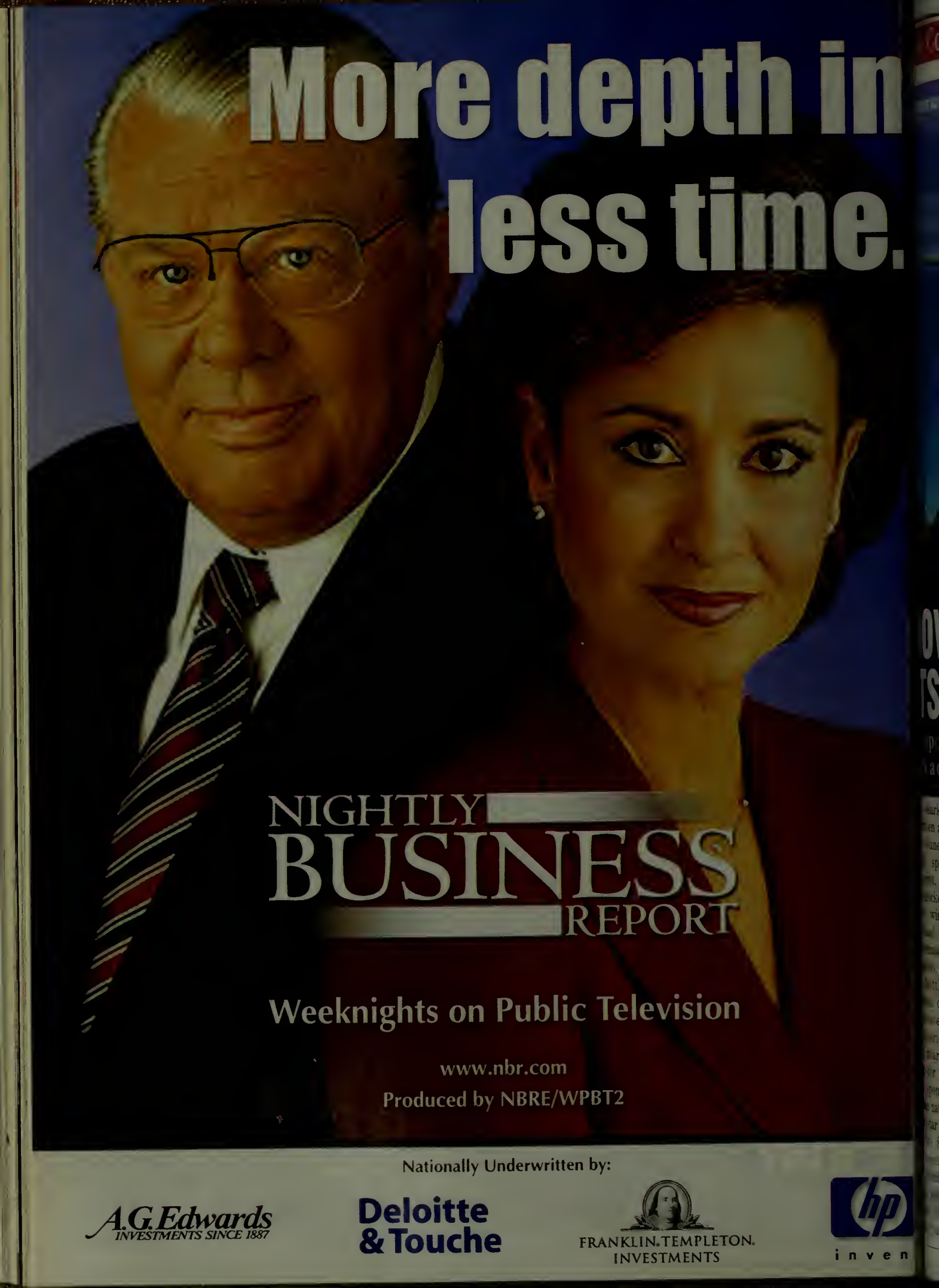
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STRATEGIES

HOW NIKE GOT ITS GAME BACK

neup changes and financial smarts
ark a comeback

Marketing execs couldn't have written a better script themselves. On June 30, Brazilian superstar Ronaldo, sporting a pair of special weight, silver-coated Nike soccer shoes, knocked in two goals in the final to win the World Cup for his mad country. The 2-0 victory over Germany was sweet redemption for Ronaldo, who

battled from career-threatening injuries. It marked a turning point for Nike Inc., which sponsored the Brazilian national team's star in a bid to reverse the \$2.5 billion soccer-gear business dominated by its rival Adidas. It's just the sort

of deft footwork that Nike will need if it's going to break free from a moribund U.S. sneaker market. The Beaverton (Ore.) giant still gets more than half of its nearly \$10 billion in annual sales from shoes. And much of the news lately has been grim: U.S. shoe sales were flat in the three months ended Aug. 31, and orders for future quarters dropped 3%. Factoring in a \$266 million charge to reflect goodwill on past

TEAMMATES: Denson (left) and Parker are playing down the \$200 sneaks

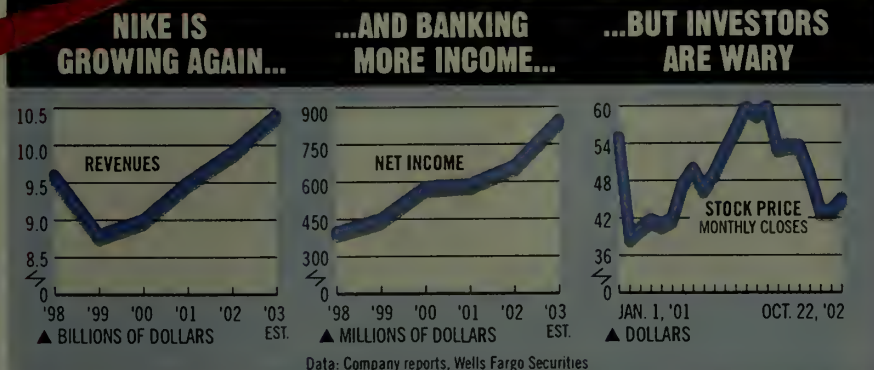
acquisitions, Nike reported a \$48.9 million net loss. The biggest shock of all: Nike's top customer, Foot Locker Inc., canceled orders for as much as \$250 million worth of business. Now Nike has to scramble to find retailers to take all those \$160 Vince Carter Shox and \$200 Air Jordans.

But the gloom is deceiving. Behind the scenes, Nike is finally making headway in its years-long quest to get back on the growth track. A few short years after some pronounced the brand finished on the basis of tepid product launches, shifting customer tastes, and its ties to Third World sweatshops, Nike appears to be displaying financial discipline for the first time and proving that it can squeeze growth out of something other than shoes.

Even Nike apparel, a chronic underachiever, finally is making significant contributions. Shirts, shorts, and other clothing generated \$2.9 billion in sales for the fiscal year ended May 31, or 30% of Nike's total, and kicked in its first meaningful profit. Global soccer revenues rose 24%, to \$450 million, last year, a dramatic jump considering Nike had virtually no soccer credibility—or sales—at the time of the 1994 World Cup. Even in golf, Nike seems to be on the way to becoming a power, on the strength of its sponsorship of Tiger Woods and the refinement of a lineup that includes balls, clubs, and shoes.

The result: Nike returned to double-digit profit growth in fiscal 2002, with net income rising 12%, to \$663.3 million. Profits should grow another 13% in the year ending May 31—albeit on only 5% sales growth, according to Wells Fargo Securities. "I think now we're a pretty well-run \$10 billion company, and we're ready to grow again," says Nike Chairman and CEO Philip H. Knight.

Even Nike's vaunted image-making machinery—so crucial to the rise of the brand in the 1990s—appears to be back on track. Whimsical television advertisements that show an entire city engaged in a giant game of tag have helped soften a brand that was too often associated with hard work rather than play. For the World Cup, Nike created global buzz with an ad that pitted its stable of soccer stars in street-style matches



The Corporation

inside a steel cage aboard a tanker.

Knight, the enigmatic company co-founder, finally acknowledged early last year that he needed to shake things up. After a torrid run in the mid-1990s—capped by a 50% burst in sales during 1997—the company simply outgrew its inventory and other systems. By 1999, sales had dropped, and profits, which peaked at \$795 million in '97, fell to \$451 million. Having accumulated the titles of chairman, CEO, and president, Knight admits he was part of the problem: "We got to be a \$9 billion company with a \$5 billion management."

The turnaround began when Knight handed over day-to-day control to a pair of Nike veterans, co-Presidents Mark G. Parker, 47, and Charlie Denson, 46. While yoking two ambitious execs can be a recipe for indecision, or worse, Parker and Denson so far have forged a smooth relationship, insiders say. Parker, originally a shoe designer, brought to market such innovations as Nike's flexible Presto and spring-soled Shox. Now he is leading an assault on sub-\$100 footwear. Denson, meanwhile, used his sales background to pare down a near billion-dollar inventory bulge, which

BUZZ

Offbeat ads showing street-style soccer in an oil tanker (left) or a whole city playing tag have returned some excitement to the brand



threatened to implode the supply chain. Among other things, he installed new computer systems to better track goods.

Although Knight has stuck with insiders for the top posts, he has reached outside for some key hires. They have blended surprisingly well with Nike's notoriously insular, athlete-dominated culture. Chief Financial Officer Donald W. Blair, hired from PepsiCo Inc. in 1999, has fostered fiscal discipline at a company that loves to spend money on

product development and marketing. For the first time in a decade, gross margin last quarter exceeded revenues. Meanwhile, Mindy Garmen, a fast-talking New Yorker two years ago from the Polo Ralph Lauren Corp., is pumping life into Nike apparel. She has slashed lead times for new outfits on the shelf from 18 months to 11 and is launching a line of lifestyle fashions. "I think the bridging lifestyle and sport a lot





and creating more fashionable looks and fabrics," says Shawn Neville, CEO of Footaction.

Nike will need to draw on all of its discipline and brand strength to stay one step ahead of fierce shoe competitors such as Adidas and New Balance Athletic Shoe Inc., which have been gaining U.S. market share. The standoff with Foot Locker, which accounts for 11% of Nike's sales, didn't help. The mess, sparked by slow sales of

Nike's premium shoes, will take months to clear up. A bigger challenge, though, is to prove Nike can be a force in lower-priced shoes. Whereas some teens once bought eight pairs of pricey shoes a year, cell phones and other gizmos now compete for their money.

That erosion of Nike's core business is a big reason its shares are

down 30% since hitting a two-year high of \$63.99 in late March. To respond, Nike is offering a relaunch of the classic Air Jordan 9 at \$125. Admitting that the initial design and high price of the Vince Carter Shox doomed sales, it will launch the redesigned second edition at the NBA All-Star Game in February. Says a sobered Eric Sprunk, Nike's footwear vice-president: "We're not going to \$200. We probably pushed that too aggressively."

Fortunately, Nike is now much less dependent on the U.S. market. Its overall international revenues have gradually grown to \$4.4 billion, now nearly matching U.S. revenues of \$4.7 billion. In the most recent quarter, Nike's sales grew 15% in Europe and 24% in Asia. A key driver of overseas growth will be soccer footwear and equipment. Last spring, to coincide with the World Cup, Nike introduced a line of radically designed shoes, jerseys, and equipment, including the Mercurial Vapor, worn by Ronaldo. It spent \$155 million on endorsements and \$100 million on ads, an interactive Web site, and 13 mini theme parks scattered across the globe.

The payoff? Nike believes global soccer revenues should hit \$1 billion within five years. Even more promising, Nike seems to be recapturing excitement among younger consumers. "When you're walking down the street, people notice—ooh, Nikes. They don't remark on Adidas," says Fahri Gürlir, a 14-year-old German soccer fan from Frankfurt. Nike isn't over the hump yet. But far from the basketball court, it seems to be getting its head back into the game.

By Stanley Holmes in Beaverton, Ore., with Christine Tierney in Frankfurt

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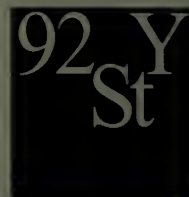
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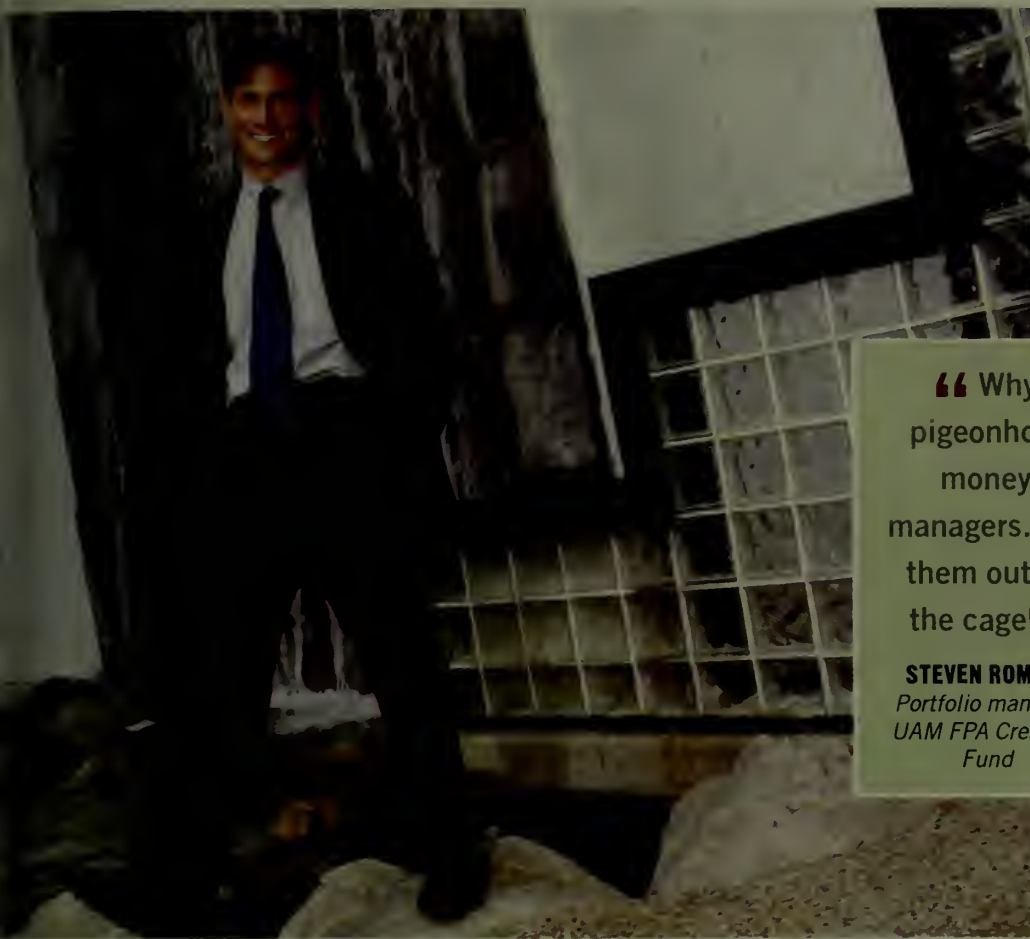
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“Why
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the cage”

STEVEN ROMICK
Portfolio manager,
UAM FPA Crescent
Fund

last few years,” says Jean-Marie Eveillard, portfolio manager of the First Eagle Sogen Global Fund.

A handful of funds have managers who, like Eveillard, operate outside the box. They choose from a wide range of investments that go well beyond common stocks into everything from junk bonds to commodities and private equity. And unlike most fund managers, in the absence of good opportunities, they hoard cash. “If you’re oriented toward absolute returns, you can’t be confined to a narrow field of investments,” Eveillard says.

Over the past three years, the talent of the managers and the flexibility of these “go anywhere” funds have really

come through (table). Most have positive returns at a time when the Standard & Poor’s 500-stock index fell an average of 10% per year. On

the other hand, although they made money during the bull market, many lagged the indexes.

The eclectic Eveillard—he invests in stocks, bonds, cash, gold, even private equity—has delivered excellent overall results. He can boast 14.6% annualized returns over the past 23 years, and his fund has held up remarkably well in this bear market. Yet in the press and on the Internet, he was criticized in the late 1990s when he sold a good chunk of assets and went to cash. From the perspective of an investor seeking absolute returns, not relative ones, the move made sense. “Buying stocks just for the purposes of being fully invested is idiotic,” says Eveillard.

Flexibility allows a manager to find the greatest values. Consider Steven Romick, portfolio manager of the UAM FPA Crescent Fund. Before he invests in a company, Romick examines the entire capital structure—its common and preferred stock, convertible debt, bank loans, bonds—to see which security offers the best risk-reward potential. He recently examined the equity and debt of beleaguered Qwest Communications and concluded that both were worth about double their present value. But the debt had a 27% yield to maturity and more downside protection: bondholders would have a stronger claim to company assets than equityholders if the company went bankrupt. He bought the bonds. “I can create a scenario in which the equity is worth zero,” says Romick. “I can’t create a scenario in which the debt is.”

Morningstar categorizes Romick’s fund as a “domestic hybrid,” a catchall group that takes in

Free-Range Funds That Outrun the Bear

“anywhere” managers are in the black

LEWIS BRAHAM

No one ever called Peter Lynch a “large-cap growth” fund manager. Back in the 1980s when he was making history with the Fidelity Magellan Fund, he just bought stocks—large-cap, small-cap, growth, value, whatever. If he thought a stock would make money for shareholders, that was good enough.

Today, few fund managers have that kind of latitude. Indeed, the vast majority of funds are boxed into categories such as “small-cap value” or “mid-cap growth”—and their success is measured by beating a specific benchmark or peer group of funds, not necessarily by making money for investors. In short, a fund can have relatively good performance and absolutely horrible results. Some managers don’t like that a bit. “There has been benchmark tyranny over the

These managers can pick from a wide range of investments—from stocks to commodities and private equity. And they also can simply hoard cash

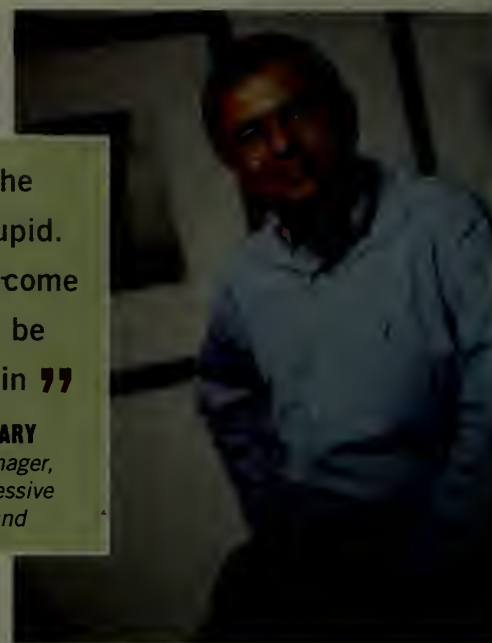
everything from funds that have strict asset allocation mandates—say, 60% stocks, 40% bonds—to those that act like hedge funds. Go-anywhere managers can wind up in any fund category or “style box,” though none will truly fit. “We have a split personality,” says Stephen Boesel, portfolio manager of the T. Rowe Price Capital Appreciation Fund. “Lipper [another fund tracker] calls us mid-cap value, while Morningstar labels us a domestic hybrid fund.” That’s because Boesel will often buy convertible bonds if they offer better value than stocks. He also buys stocks of any market capitalization.

Russel Kinnel, Morningstar’s director of fund analysis, agrees that some of the best managers are hard to pigeonhole, but he says style-specific funds add value. “It can be dangerous if every manager in your portfolio is given free rein,” he says. “There can be a big opportunity cost if they’re all out of the right sector that rallies or in the wrong one, and you don’t know it.” If you like free-rein funds, Kinnel suggests using them alongside index funds, so you’ll know exactly where part of your money is.

Many of the go-anywhere managers have a value slant—they like to buy cheap. But not all.

“It’s the profits, stupid. If earnings come back, I’ll be bullish again”

MANU DAFTARY
Portfolio manager,
Quaker Aggressive
Growth Fund



Manu Daftary, who runs the Quaker Aggressive Growth Fund, cares more about earnings than valuations. He delivered a big 96% turn in 1999, investing heavily in tech but when the earnings dried up in 2000, he moved more than half the portfolio into cash and started shorting stocks. “It’s the profits, stupid,” he says. “If earnings come back, I’ll be bullish again.” His cash position remains at 15%.

While Daftary says about 80% of the stocks he buys have a “growth component” to them, he’s not afraid of owning traditional value stocks, such as retailer AnnTaylor, which has a low earnings ratio of 12, and Nextel Communications, which is also cheap relative to its earnings. Some value managers such as Legg Mason’s William Miller dabble in growth stocks. The most flexible fund, Legg Mason Opponent, now has more than 11% of assets invested in Amazon.com’s stock and bonds. The company has no earnings, at least as measured by Generally Accepted Accounting Principles, and a lofty price-to-cash-flow ratio of 152.

Some go-anywhere funds—such as the Evergreen Asset Allocation and Leuthold Core Investment funds—make quantitative evaluations of entire asset classes. Evergreen’s fund, previously known as GMO Global Balanced Allocation, invested in 14 asset classes, including inflation-indexed bonds, real estate stocks, and currencies. Although their approach is different, these “downside” or “macro” funds have the same objective: delivering absolute returns.

Evergreen manager Jeremy Grantham says the fund’s makeup is almost identical to the one he manages for his sister’s pension plan. “If we were running your sister’s money, you’d say, ‘How can I optimize the asset allocation to deliver a safe, stable return?’” he says. “He wouldn’t just try to beat a benchmark.” His fund is up 5% since the bear market began in 2000. Sticking to the U.S. stock market alone would have cost his sister some 40%. Fortunately, his sister can invest anywhere.

Unfettered Funds

FUND/SYMBOL	AVERAGE ANNUAL TOTAL RETURN*	
	3-YRS.	10-YRS.
EVERGREEN ASSET ALLOCATION EAAFX**	5.7%	NA
A quant approach with a value slant; now with stakes in 14 different global asset classes		
FIRST EAGLE SOGEN GLOBAL SGENX	9.5	10.3
Basically equities, but also finds value in high-yield bonds, gold, and cash		
GREENSPRING FUNDO GRSPX	4.5	7.9
Value equity fund supplements holdings with convertible bonds and preferred stocks		
LEGG MASON VALUE LMVFX	-8.0	14.0
Buys large-cap value stocks, also veers into tech stocks and distressed debt		
LEUTHOLD CORE INVESTMENT LCORX	2.9	NA
Quant fund does almost everything: growth and value stocks, high-yield bonds, short sales		
MUTUAL DISCOVERY TEDIX	5.9	NA
Value equity fund, often investing in mergers, bankruptcies, and corporate reorganization		
QUAKER AGGRESSIVE GROWTH QUAGX	7.4	NA
At the core, a growth fund but also uses value stocks, options, cash, and short sales		
SMITH BARNEY PREMIUM TOTAL RETURN SPTX	-4.0	6.7
Supplements growth stocks with real estate stocks, convertible bonds, and options		
THIRD AVENUE VALUE TAVFX	4.2	12.0
Value stock fund also buys distressed debt, real estate stocks, and tech stocks		
T. ROWE PRICE CAPITAL APPRECIATION PRWCX	9.8	11.4
Has a large-cap value slant, but also buys midsize companies and convertible bonds		
UAM FPA CRESCENT FPACX	11.3	NA
Can invest across the entire capital structure of a company		
W&R ASSET STRATEGY WASCX	7.1	NA
Actively moves money between U.S. and foreign stocks, bonds, cash, and gold		

* Appreciation plus reinvestment of dividends and capital gains, as of Oct. 21, 2002

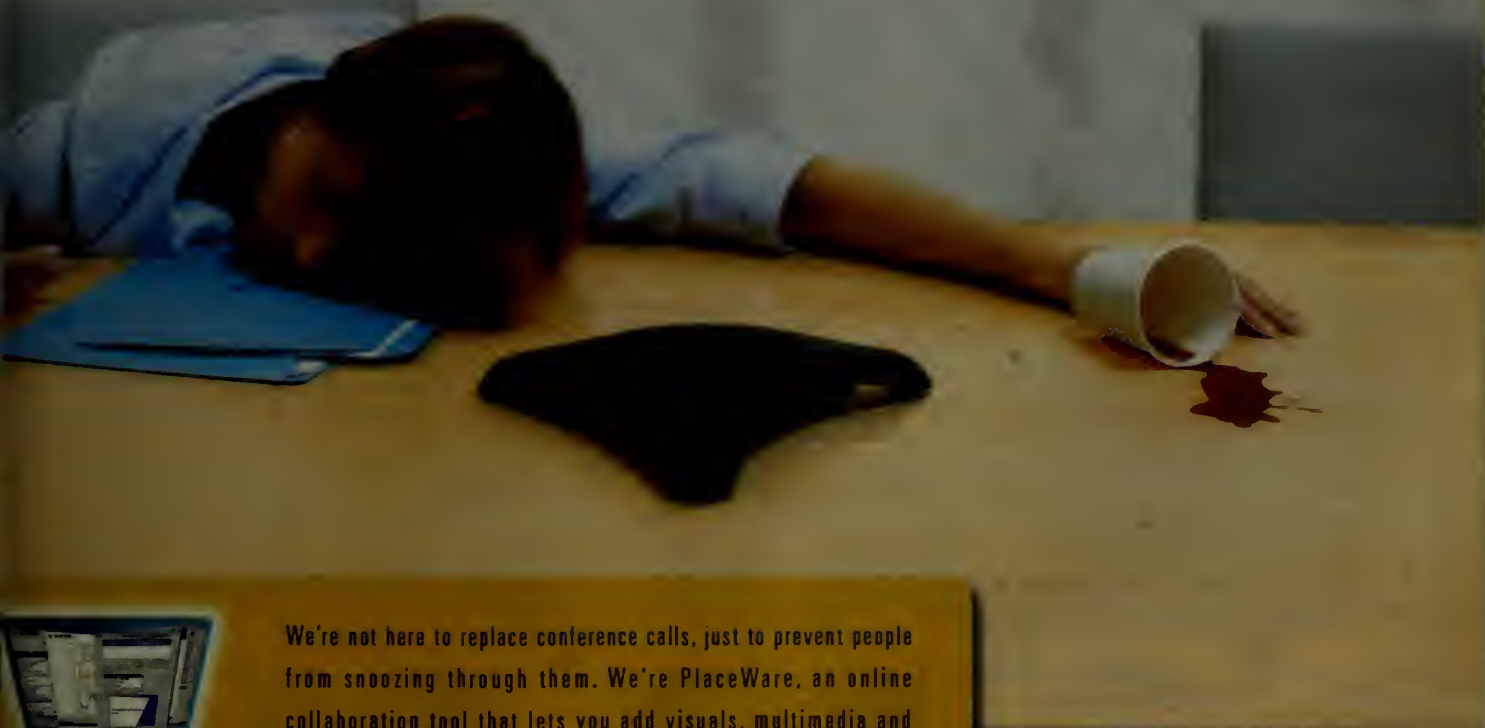
** Returns include period when the fund was called GMO Global Balanced Allocation

NA=Not available

Data: Morningstar

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From Heroes To Bums?

The boom may be over for mortgage funds

BY GEOFFREY SMITH

Over the past three years, investors with sinking stocks sought shelter in mutual funds that invest in pools of long-term mortgages usually guaranteed by the federal government. They've been well-paid, too, earning nearly as much as they would have on far more volatile U.S. Treasury funds (table).

Now, some portfolio managers of mortgage-backed securities funds are raising a warning flag. With rates on home mortgages climbing up from 40-year lows, the boom days may be over. "Returns will be half of what they've been, and negative returns aren't out of the question" over the next 12 months, says Paul Kaplan, who runs the \$26 billion Vanguard Ginnie Mae fund, the largest of its kind.

The risk in mortgage funds became apparent during Wall Street's recent surge. As investors bought stocks, they dumped bonds—especially 10-year Treasuries, the issue against which home lending rates are set. That sent long-term mortgage rates sharply higher, from about 6% to 6.25% during the seven days ended on Oct. 16, according to *Bank Rate Monitor*. Since the prices of mortgage-backed securities—issued mainly by Government National Mortgage Assn., Fannie Mae, and Freddie Mac—fall as rates rise, the funds' net asset values sank. The Fidelity Ginnie Mae Fund, for example, lost half a percentage point in value during the week.

This is hardly the kind of roller-coaster volatil-

er-yielding mortgages that get bundled in securities. The result has been steadily declining yields for these funds. The yield on K fund, for example, dropped from 6.4% in January to 5% in mid-October. Total returns remained strong, however, because the lower rates increased the value of the remaining mortgages.

Now, the funds are stuck with more lower-coupon paper. Even if mortgage rates are rising, fund managers worry their funds will struggle. "As mortgage rates hover around year lows, it gets harder and harder for mortgage funds to have any price appreciation," says Tom Silvia, who runs \$8 billion in mortgage funds for Fidelity Investments.

If rates continue to climb, the funds may get an even bigger hit. Kaplan says 7% mortgage rates could result in zero total return for funds invested in Ginnie Maes. And 8% rates could produce negative results.

Still, mortgage funds can be attractive to income-oriented investors who are willing to ride out the ups and downs in the funds' net asset values. Mortgage funds should continue to pay dividends that exceed those of money-market and

term U.S. Treasury funds. Because borrowers pay above Treasury rates for mortgages, in 1994, their worst year in the past decade, the average return of mortgage funds was -3.6%, but their average yield was 7.25%.

Not all mortgage managers are bearish. Jeffrey Gunn, head of fixed-income investments at Trust Company of the

thinks that "if rates rise, mortgage funds likely be the top performers" among fixed-income mutual funds, because U.S. Treasury corporate bond funds fall more quickly in response to rate increases, he says.

Even with the risk of higher rates, some investors may decide it's worthwhile to hold mortgage funds. But anyone jumping in now is paying top-of-the-market prices.

An Envious Record

In recent years, mortgage-backed funds have surpassed short-term Treasury funds and the average taxable-bond fund. They also nearly matched the returns of the more volatile general Treasury funds.

FUND CATEGORY	TOTAL RETURN*				
	1998	1999	2000	2001	2002**
U.S. MORTGAGE	6.21%	0.69%	10.35%	7.58%	6.96%
GENERAL U.S. TREASURY	11.01	-5.73	15.66	4.63	11.99
SHORT-TERM U.S. TREASURY	7.04	1.29	8.04	6.96	5.26
ALL DOMESTIC TAXABLE	4.88	0.43	3.96	5.06	0.91

*Appreciation plus reinvestment of dividends and capital gains, before taxes

**Through Oct. 10

Data: Lipper

ity investors experience in the stock market. But fund managers fear the problems will only worsen over the next year. Their concerns: the refinancing boom and rising interest rates.

Refinancing is great for borrowers but a problem for mortgage funds. Consumers who refinance pay off their old loans, and the principal is returned to investors—such as mortgage fund managers—who must reinvest in the newer, low-



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ON SALE: (who owns Christie's International), retired investment banker Logan, Wellesley College

real estate investor Gerald Fineberg, San Francisco investment banker Thomas Weisel all have important contemporary pieces for sale at the big New York auctions in November. It's hard not to conclude that these collectors—all savvy investors in their day jobs—are raising in anticipation of a market slump.

To gauge the market's health, watch Weisel's sale at Sotheby's Nov. 12 auction in New York, which is expected to fetch up to \$60 million. The 21 works Weisel is selling, by such artists as Willem de Kooning and Franz Kline, are among the best to come on the market in recent years. Weisel spokeswoman says the collector is unloading a fraction of the art he owns.

But art market sources say he's selling the rest of his collection—and asking high prices.

Another bellwether, notes Laura Paulson, director of contemporary art at Sotheby's New York, will be what Andy Warhol pieces command. Warhol prices have tripled in recent years, leading collectors to sell important paintings also for top dollar. An art market source says Fineberg (who didn't return calls) is the seller of a double Warhol self-portrait, estimated to fetch up to \$3.5 million, that is part of Christie's 13 New York auction. Another major Warhol work, *Silver Liz*, a portrait of Elizabeth Taylor, sold for \$6 million at Phillips, de Pury & Luxembourg's New York sale. The auction house thinks it will go for \$6 million. Warhol is hugely popular, but prices of his works soared and then tanked in the 1990s, and it could happen again.

Insiders profess confidence. "The market



\$10 MILLION? *De Kooning's Orestes, 1947*

go down now because there's so much work [on sale]," says Amy Cappellazzo, who is selling contemporary art at Christie's in New York. "A correction probably isn't far off. "It could be like the stock market, where people kept buying in '97, '98, and '99 that prices were too high," says New York collector Arthur Goldberg. "Prices were wrong, but when the bubble finally burst, there was hell to pay."

It May Be Time To Unload that Warhol

Art prices are strong, but a correction may be near

BY THANE PETERSON

Several savvy collectors—who are savvy investors by day—have placed some of their most important pieces in November's New York auctions

At a tony art gallery in Manhattan recently, a collector was agonizing over an expensive work of contemporary art he coveted. Turning to gallery owner Ronald Feldman, he wondered: "Should I buy this, or should I buy GE at \$24 a share?"

The joke sums up the zeitgeist in a contemporary art market that's so hot it may be burning itself out. The price of post-World War II art soared 16% in auctions in the first half of this year, vs. 6% for the overall fine-art market, says Paris-based Artprice.com, which tracks world auction results. And while stocks have plunged, art worth more than \$100,000 has returned more than 12% annually since 1996, Artprice figures. Many investors again see art as an attractive alternative investment and contemporary works as the equivalent of NASDAQ stocks—risky but rewarding when they pay off.

Now, even if war with Iraq or some other calamitous event doesn't touch off a correction, most veteran collectors doubt the market can get through the next year without a slump. "In some ways, it's reminiscent of the market 12 years ago," says Los Angeles collector Eli Broad, chairman of financial-services giant SunAmerica. Back then, a plunge in Impressionist prices touched off an art market crash; bears fret that the same thing could happen now if contemporary art prices go south.

Several veteran collectors are selling. Such art market luminaries as France's François Pinault

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Genscape Inc.
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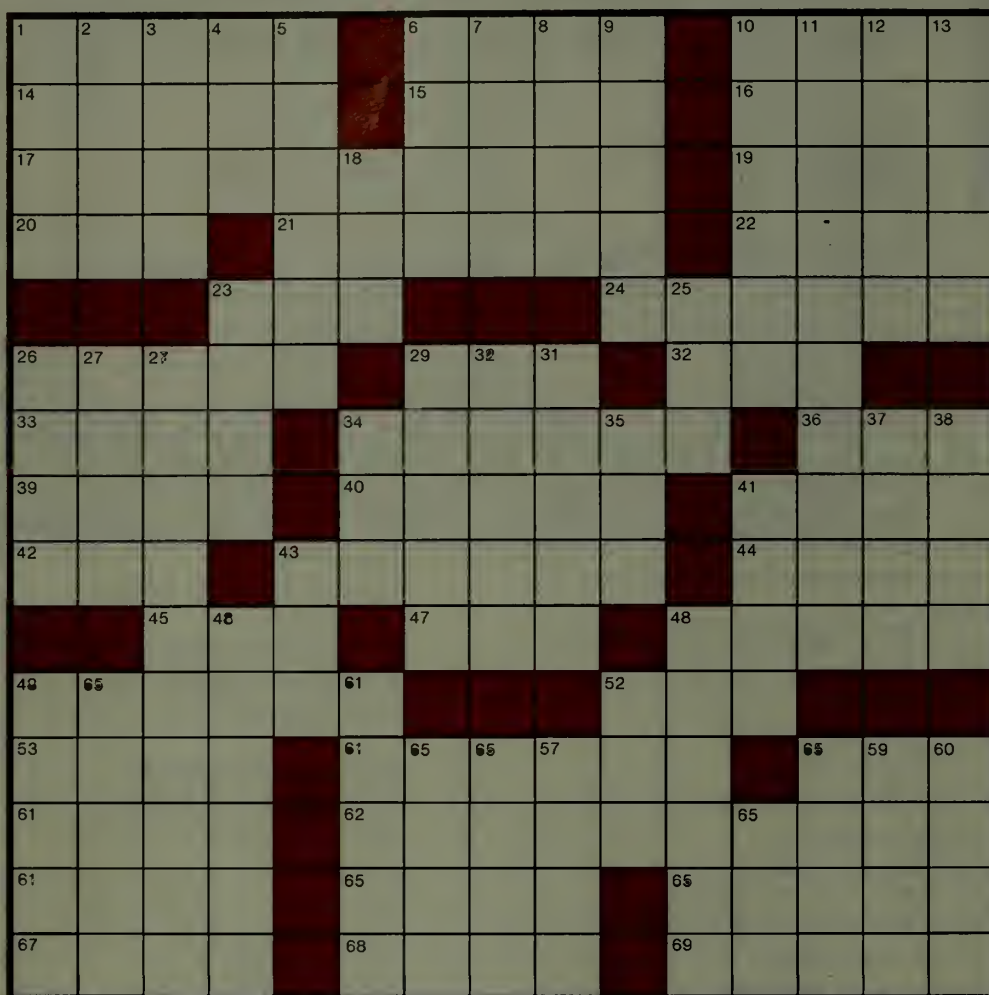
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14. Electron tube
15. Phrase of understanding
16. Biblical preposition
17. R&D objective
19. Hotshot performer
20. Golf area
21. Gasoline rating
22. Executor, often
23. Verizon ancestor

24. Gyroscope inventor
26. Stock distribution
29. Family member
32. African snake
33. Mediator's asset
34. Trainee's guru
36. Suite units: Abbr.
39. Freudian topics
40. Uncle Sam feature
41. Parting word
42. Sat down with
43. Like some income
44. Former UN member
45. Impose a levy on
47. Replace a button

48. Procter and Gamble brand
49. Technical analyst's creations
52. Unruly bunch
53. Take on cargo
54. Crayola's home
58. Computer's "brain"
61. Enthusiasm
62. Signs off on
64. ___ mater
65. Shoe preserver
66. In the know
67. Scottish loch
68. Identical
69. College quarters

DOWN

1. Word-processor com
2. Eat well
3. Vanished
4. Fuss
5. Call the role again
6. German figure skate
7. Home to billions
8. Light gas
9. "___? Yes." (see page
10. The First Family
11. Business venture
12. Elevator alternative
13. Regrettable
18. Top-drawer
23. Courage, so to spea
25. Nominal ___ (face v
26. Accounting entry
27. Wise one
28. "Dilbert" cartoonis
29. Prognosticators
30. Silly
31. Scatter
34. Kellogg School offe
35. Like some lots
37. Part of an Einstein e
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41. New York ___ Excha
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46. Battlegrounds
48. Hotelier Hilton
49. Sanitize
50. Actress Berry
51. "Climate-controlled fr
- (see page at right)
52. Pasture sound
55. Ambiance
56. Arise (from)
57. "Of ___ I Sing"
58. Powerful leader
59. Salon order
60. Benefits by
63. ___ Jima

For answers to this puzzle:

Turn to page 153 in this week's issue of BusinessWeek or visit Mixing Business with Pleasure by Lincoln on www.businessweek.com/adsections

Puzzle created by: Stanley Newman.



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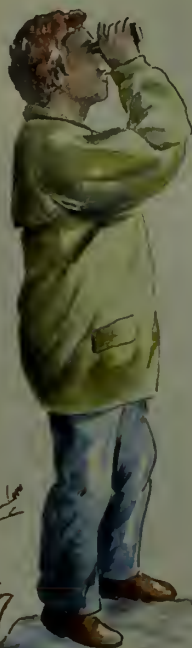
Walk Softly, and Bring Binoculars

Birding is the nation's fastest-growing outdoor activity. Here's how to get started

BY KIMBERLY WEISUL

Birds As Far As the Eye Can See

Winter offers birders a chance to see species not usually found in their region. Some highlights from around the country:



Most of us can recognize a few common birds: robins, cardinals, blue jays, seagulls, and maybe some hawks and hummingbirds. Beyond that, our fine feathered friends are mostly just a blur of little brown birds. But more and more Americans are keen on distinguishing a ruby-crowned kinglet from a cedar waxwing. In fact, birding is the fastest-growing outdoor activity in the nation, according to the Agriculture Dept.'s Forest Service, which found that 71 million people watched birds in 2000, up from 21 million in 1982.

And why not? Birds are beautiful creatures that have captured humans' fancy at least since the Etruscans studied their flight patterns for clues to the future nearly 3000 years ago. You can enjoy bird-watching at any age or in any physical condition, and you don't have to spend a lot of money to do it. Birding can mean sitting on your deck with a pair of binoculars and an iced tea or trekking through rugged mountains trying to identify scores of species in a single day.

If you're interested in sharpening your avian acumen, getting started is easy. Just don't do what I did: head to the local park with *The Sibley Guide to Birds*, a beautiful 544-page tome that is totally unsuitable for beginners, and the wrong binoculars (a borrowed pair I couldn't use without removing my glasses). I would find a bird in the brush, fumble with the binoculars, fumble with my glasses, fumble with the binoculars again—and the bird would be gone. Locating birds in the book was no easier because they were categorized under oh-so-helpful headings such as "mimids" and "trogons."

You can do better. First, get a field guide that's easy to use and specific to your geographic area (the Eastern or Western half of the U.S.), so you don't have to slog through many pages of descriptions of birds you're unlikely to see. The Petersen's field guides to the birds of North America (Houghton Mifflin, \$22) are classics. They feature illustrations for each bird, even though at first glance, photos may look more realistic to untrained eyes. But illus-

trated guides can clearly show all the bird might have that would help you identify even though any individual bird might not have all of these markings. And illustrated guides cram more species onto a page, which means you'll spend less time flipping around.

If you insist on a photographic guide, *Field Guide to Birds* (Little Brown, \$19.95) is well-regarded. Kenn Kaufman's *Birds of America* (Houghton Mifflin, \$20) uses digitized photos to make sure each bird's markings are visible.

Finding the right pair of binoculars is a little, too, though it may take some time.

CALIFORNIA

Monterey Bay is famous for its cormorants, petrels, murres, and albatrosses



NEW MEXICO

Bosque del Apache National Wildlife Refuge hosts thousands of sandhill cranes



TEXAS Santa Ana Wildlife Refuge is full of hummingbirds and green jays

ing the binoculars to your eyes, you should
 arly and easily," says Pete Dunne, director
 Cape May Bird Observatory. "If you
 le, it's wrong." That said, he offers a few
 s. Look for binoculars with 7 or 8 "power"
 the first number in the description, as in
 Higher power binoculars are hard to hold
 and good ones cost a bundle. The second
 r is the lens diameter—the bigger it is, the
 you'll see in low light. A good minimum
 lens diameter is 30.

the binoculars before you buy them. They
 focus quickly, and you should be able to
 em one-handed. If you wear glasses, try
 lars with rubber eye cups that can be
 back to make viewing more comfortable. A
 entry-level binocular is the Nikon Natu-
 IV 7x35, for about \$100. The Swift Ultra-
 ne and the Swift Audubon 8.5x44 are both
 choices and under \$300.

ally, there are the birds. Start with your
 ard, a local park, or a nearby wildlife
 . Once you find a bird that's not too hidden
 away, take a good look. Maybe the bird is
 and plump with a long, dark tail, a white
 and subtle gray-and-white stripes on its
 That could be an eastern phoebe, if it's
 a soft gray color, or

maybe a least flycatcher, if it's more olive brown.
 But don't consult the field guide yet. You don't
 want to miss the bird while you're thumbing
 through the book.

Once you've got a good picture of the bird in
 your head, then turn to the guide. If the bird
 was tapping its tail, it could indeed be a phoebe;
 with a white ring around its eye and yellow on
 its beak, it's more likely the least flycatcher. The
 guide will tell you.

If all that reading and analysis sounds like a
 little too much for you alone, call the nearest
 chapter of the National Audubon Society, a state
 park, or a wildlife refuge and ask about bird
 walks and clubs for beginners. Or try the Web
 site birdingpal.com, which helps you find experi-
 enced birders in your area.

On any bird walk, just remember to keep
 your voice low and let the most knowledgeable
 folks go first. Stick close to the group leaders,
 and they'll point out and identify birds, help you
 find them in your binoculars, and answer ques-
 tions about what makes
 each bird distinctive.
 With luck, their enthu-
 siasm will help you un-
 derstand why birding
 has so many fans. ■

OHIO Magee Marsh and
 Sandusky Bay hold
 thousands of black
 ducks, ruddy ducks, and
 ▼ pintails

ILLINOIS

▼ Short-eared owls
 and northern
 harriers spend
 winters on the prairie

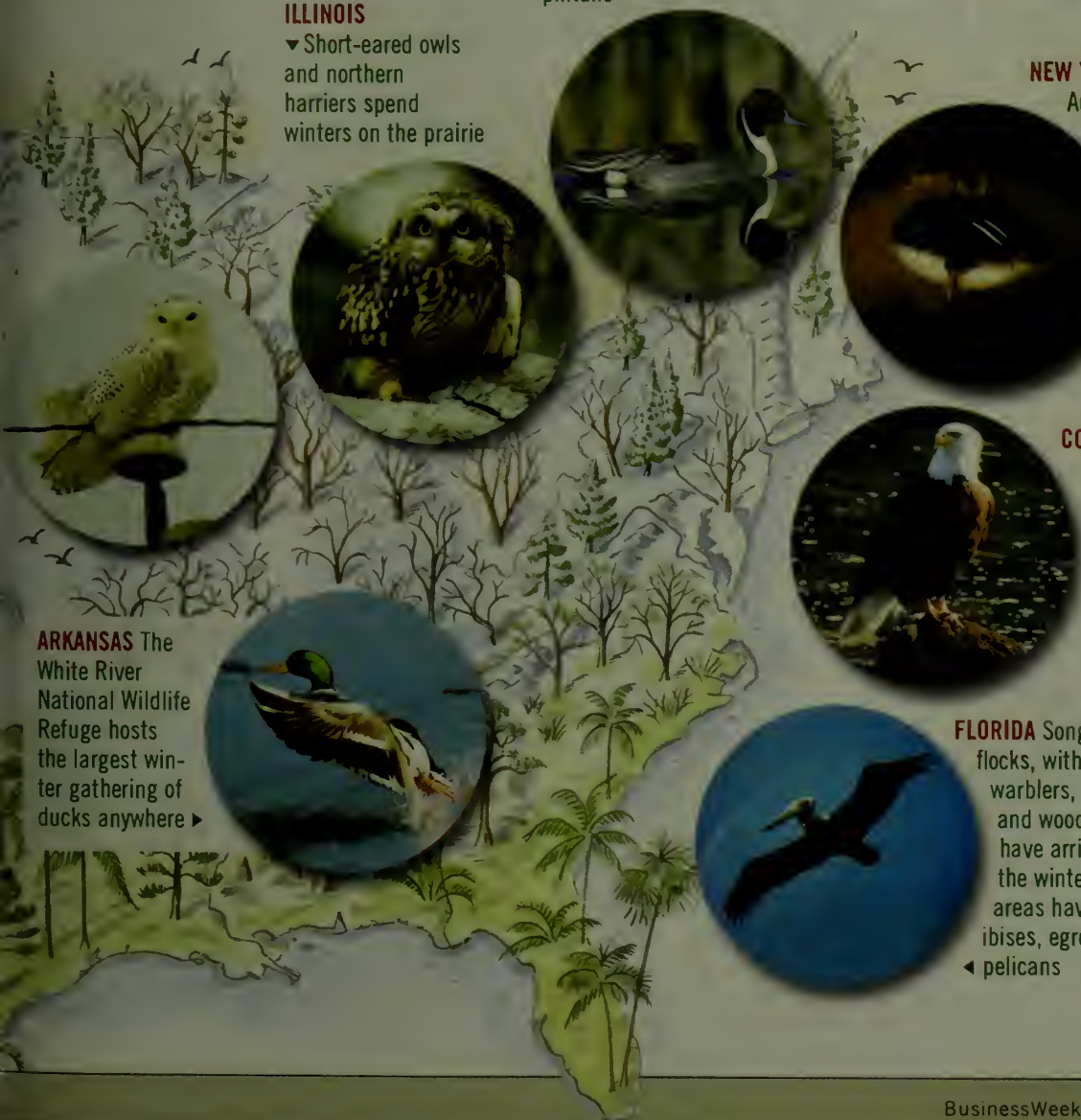
NEW YORK A kid-friendly
 Audubon center in
 Brooklyn's Prospect
 Park helps
 children find
 ruddy ducks,
 ring-necked
 ducks, and
 ◀ hooded
 mergansers

CONNECTICUT

Connecticut
 Audubon runs
 boat trips to view
 ◀ bald eagles
 wintering on the
 Connecticut River

ARKANSAS The
 White River
 National Wildlife
 Refuge hosts
 the largest win-
 ter gathering of
 ducks anywhere ▶

FLORIDA Songbird
 flocks, with
 warblers, vireos,
 and woodpeckers,
 have arrived for
 the winter. Coastal
 areas have herons,
 ibises, egrets, and
 ◀ pelicans



VIEW FROM
MOUNT ROYAL

Montreal's Icy Sparkle

Bundle up to enjoy the city's romance—and great food

BY DIANE BRADY

Despite its fragile economy and faded exterior, Montreal retains an allure that's hard to find in other parts of North America. The French-Canadian culture and language give the city a European feel, yet English speakers can still move around with ease. Its location 37 miles from the U.S. border and a Canadian dollar that's worth about 65¢ U.S. make it especially attractive to Americans looking for a quick getaway. No wonder more than 10 million people visit each year, including about 1.5 million Americans.

But few foreigners think of visiting in winter. January temperatures average in the teens, and snow can easily exceed the height of most boots. While it's possible to traverse the city center through a subterranean network of shops, hanging out underground is no way to experience wintry Montreal.

Pack a warm parka, and you'll find plenty of reasons to venture outside. Heading the list is the Montreal High Lights Festival, or *Montreal en Lumière*, which runs from Feb. 13 to Mar. 1. The city is alive with fireworks, outdoor performances, and a sprawling roster of other cultural events. Numerous streets, monuments, and famous landmarks, such as Notre Dame Basilica, are also illuminated. Several top-name acts normally

come to town, while dozens of theaters, orchestras, dance troupes, and others host special events. A culinary festival will feature workshops, wine and food tastings, and dining specials with guest chefs from around the world.

Montreal boasts most of the marquee luxury hotel brands, including Ritz-Carlton, Westin, Inter-Continental, Fairmont, and Loews hotels. Good hotel rooms can be had for the equivalent of \$150 U.S. per night. More important, the city

is a dining delight. A personal favorite: Gilt, a fabulous steakhouse located in the 200-year-old Youville Stables in Old Montreal. You can order wine, appetizers, and dessert along with your entrée and still pay less than \$100 a person for a romantic meal. Before or after you take some time to wander around the streets of Old Montreal and the Old Port. In winter, horse-drawn sleighs depart from Jacques-Cartier Pier, and skaters head for the massive Iroquois Basin Skating Rink.

A winter weekend in Montreal offers pleasures. Head downtown to the Casino Montréal for gambling and the musical variety shows of its Cabaret. Take in a Montreal Canadiens hockey game at the Molson Centre on Antoine Street West. Walk around Mount Royal, which offers fabulous views of the city. Enjoy the architecture and vibrant student life at the city's top-ranked McGill University or go shopping in the malls and stores along funky St.-Catherine Street. (If you spend at least \$150 on hotel items during your stay, you'll be able to get back much of the 7% federal goods-and-services tax at duty-free shops near border crossings.)

When you get hungry, try one of the local specialties such as *pâté*, or meat pie, baked pea soup, or *poutine*, a creative concoction of french fries, gravy, and cheese curds throughout the city.

And you must try Montreal bagels. They're smaller and chewier than their New York counterparts and, locals say, far tastier. The most famous spots are Fairmount Bagelry at 74 Fairmount Ave. and St.-Viateur Bagels, which is at 263 St.-Viateur West. Various other spots around the city. The stores are all open



OLD WORLD: St. Louis Square

hours, and Montrealers fiercely debate which product is better.

The Montreal winter can be a challenge, but it's worth the trouble. Indeed, you might find that the white wonderland is a welcome respite from the slush and damp chill that typifies winter in other cities. While the cafés may mostly close their doors and locals may bundle up, Montreal remains a lively destination even during the coldest months.

Quebec Travel

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www.habs.com
(Montreal Canadiens)

www.icehotel-canada.com

www.tourisme-montreal.org



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MY FAVORITE MUTUAL FUND



BY ROBERT BARKER

rb@businessweek.com

Not only does it produce solid returns at little risk but the Vanguard Balanced Index Fund involves hardly any time or worry

Many people enjoy spending time with their investment portfolios. This column, all about my absolute, No. 1, all-time favorite mutual fund, is for everyone else.

Now marking its 10th birthday, my favorite fund can't boast the highest returns over any period. It's cheap, but it's not the cheapest. Neither is it the biggest, the nimblest, the most tax-efficient. You'll never see its managers on TV, talking up the fund behind bright smiles. It is in no way exclusive or exciting. What it is is good—quietly, determinedly, simply good. Its name is Vanguard Balanced Index Fund (table).

You laugh: A balanced index fund? My favorite? Please hear me out.

Having first bought Vanguard Balanced Index back in 1992, I've gotten pretty familiar with it and now always think of it by its ticker symbol, VBINX. Like any human creation, VBINX has its flaws. Since it has a relatively high income yield, for example, it's not well-suited to the taxable accounts of people in high tax brackets. But as sometimes happens, when I'm asked which single fund is best for someone who is just beginning to invest, or someone who wants to vastly simplify a portfolio, or someone who wants to own just one fund, I always say VBINX.

As you might guess, VBINX is the brainchild of Vanguard founder Jack Bogle. In 1986, Vanguard followed the budding success of its flagship fund, the one that tracks the Standard & Poor's 500-stock index, with another that follows the broad bond market. In April, 1992, Vanguard brought out another fund to track the entire U.S. stock market via the Wilshire 5000 index. A few months later, Vanguard put these two basic strategies—indexing the full domestic stock and bond markets—together in yet another fund, VBINX, with the classical mix of 60% stocks and 40% bonds kept constantly in balance. "It has been singularly successful," Bogle told

me the other day, "and not particularly

Too true. In 10 years, VBINX has just \$4 billion in assets (including all shares). By contrast, Vanguard Total Stock Fund in about the same time grew to \$1.5 billion. So what has the crowd missed about VBINX? First, with an expense ratio of 0.22%, it's a surprisingly low-cost way to own, at last, a diversified portfolio of stocks and 529 bonds. That's efficient allocation. Second, it captured much of the decade's rewards from investing at relatively low risk. VBINX easily beat the typical

fund, delivering more return at less risk (charts).

That much I had to learn the hard way. But VBINX also did pretty well even against an all-stock portfolio. Back in 1992, I put my family's first investment into VBINX. I had a choice: I could have urged instead to invest in an S&P 500 index fund. In most of the years since then, the index would have been a better bet. More recently, though, the index and the bull market have narrowed the gap. VBINX has automatically. I'm still a few hundred bucks poorer than I would have been if I had invested in all stock all the time. Yet the bonds in VBINX made such anxious investors like me feel safe. Russia's default and the Asian Term Capital Market crisis, not to mention the recent crash in stocks, didn't bother me. Otherwise, I might have cashed out.

Which leads me to the single best attribute of my favorite fund: the mix of shares of time and money. VBINX takes. Investing imposes dollars-and-cents costs. An even steady stream can come in distracting what's more important. About other investment questions seem to come to our heads week in, week out. Has the portfolio made it? Wait—I

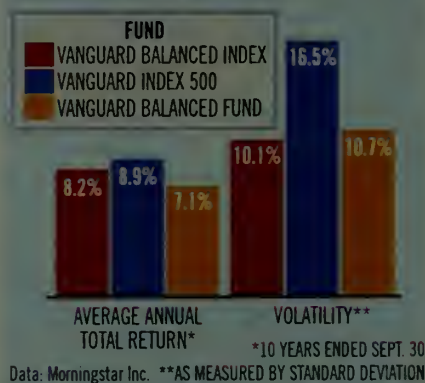
running off to open a hedge fund—should I sell the mutual fund now? Do I own too many caps? Too few growth stocks? Maybe more energy and less tech? Dump my day—or after the Federal Reserve meeting. As it silently tracks the full stock market, rebalancing itself daily, VBINX squelch all such worries. Just most of

Vanguard Balanced Index Fund...

Symbol	VBINX
Assets	\$2.8 billion
Annual cost per \$10,000 in assets	\$22
Annual cost of average balanced fund per \$10,000 in assets	\$125
Current Income	Yield: 3%
Worst Year	2002 -11.3%*
Best Year	1995 +28.6%
Investment minimums	\$3,000 or \$1,000 for IRAs
Phone	800 662-7447

All data for Investor class shares * Through Oct. 17
Data: Vanguard Group, BusinessWeek

...Strikes a Good Balance



BusinessWeek online

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S&P SAYS: GOING UP



BY GENE G. MARCIAL

Buy now for the recovery, advises a top strategist. As the big airlines falter, Mesa's jets rev for takeoff. Doing legwork for the IRS could put NCO on easy street

As debate rages about whether the market has bottomed, Standard & Poor's is casting its vote on the side of the bulls: "We think the Oct. 9 low of 776.76 in the S&P 500 is the low for this bear market," declares Sam Stovall, chief investment strategist at S&P, which, like *BusinessWeek*, is a unit of The McGraw-Hill Companies. The market won't skyrocket, he adds, "but the worst is over. We've reached bottom."

S&P's investment policy committee, peopled by chief economist David Wyss, director of equity research Kenneth Shea, index chief David Blitzter, chief technician Mark Arbeter, and Stovall, make the calls. They meet each week to analyze where the market is and where it's headed. "Right now, we're cautiously optimistic: The market will wait for earnings to catch up before it makes a major move upward," argues Stovall, who expects the S&P 500-stock index to rise to 1,155 in the summer of 2003—a 35% leap from 857, where it stands now. That's in line with the S&P's historic performance—from 1949 through 1990—when the index typically posted a 33% gain nine months after the end of each bear market. With S&P forecasting gross domestic product growth of 2.7% in 2002 and 3.5% in 2003, it sees corporate earnings rising 20% in 2002 and in 2003.

So it's wise, says Stovall, to invest in sectors that do well in recoveries: consumer durables, energy, and materials such as paper, chemicals, and metals. In consumer goods, S&P's top picks include homebuilder Home Depot (HD) and Wal-Mart Stores (WMT); in energy, oil explorer Apache (APA) and driller Nabors Industries (NBR); and in chemicals, Praxair (PX) and fertilizer producer IMC Global (IGL).

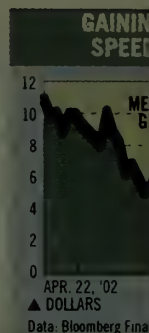


STOVALL: A 35% rise by summer

IS MESA SET TO FLY HIGHER STILL?

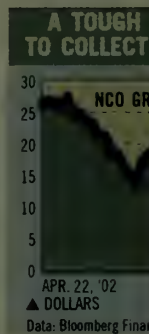
Mesa Air Group's (MESA) Mesa Airlines, a regional carrier serving 150 cities in the U.S., Canada, and Mexico, is becoming an important feeder to the biggies. As a result, one analyst says he may boost his 2003 earnings estimate. An immediate reason: On Oct. 18, Mesa agreed to fly an additional 20 of its 50-seat jets for US Airways, which filed for bankruptcy protection in August. Mesa, with a fleet of 68 regional jets and 58 turboprops, already flies 32 regional jets for US Airways Express, as well as for America West and Midwest Express. Analyst Jim Parker of Raymond James Financial, who rates Mesa a strong buy, thinks "there could be

more US Airways jets for Mesa beyond those 20." So his 2003 earnings forecast of 80¢ a share, he says, "could be increased." For 2002, he expects 51¢, up from 2001's 36¢. Mesa also agreed to use pilots furloughed by US Airways for the 20 jets. "This is good news," says Parker, because the majors will need the regionals more now—not less. They're low big airlines to lease fewer expensive replacing them with small jets. "The regionals are the sweet spot in the industry. They could change from allies into rivals for the majors" for trips of less than 1,000 miles, says analyst Sven Monberg at GunnAllen Financial. The stock, now at 5.45, trades at just 8.5 times estimated 2002 earnings and 6.3 times 2003. Monberg expects earnings to jump in 2003, which is why he thinks "Mesa is one of the better risk-reward bets in the group." MESA has a 12-month price target of 10.



NCO MAY BE GOING AFTER TAX DEADBEATS

If the Internal Revenue Service decides to outsource the collection of more than \$1 billion in back taxes, watch the shares of National Collection Operations (NCO) rocket. NCO is the world's largest accounts-receivable management company, and likely to get a big slice of the IRS business, should Congress O.K. the plan. If it does, outsourcing could start by 2003, figures Sakakeeny of Deutsche Bank Securities, who owns 1% of the stock. It's too early to gauge the potential impact on NCO, he says. Gary Steiner of Awad Asset Management says NCO shares, which have tumbled—from 29 in March to 11.92 on Oct. 23, are "very undervalued—even without the IRS project." Awad has accumulated a 5.1% stake. NCO is trading at seven times Steiner's 2002 earnings estimate of 1.50 a share. He thinks it should trade at 15 times, or 22 a share. He expects earnings of 1.79 in 2003. NCO gets 25¢ to 28¢ of every dollar it collects. The business has continued to grow, says Steiner, but the recession caused missed forecasts as debtors found it difficult to pay their loans. "The drop presents a great opportunity," he says.



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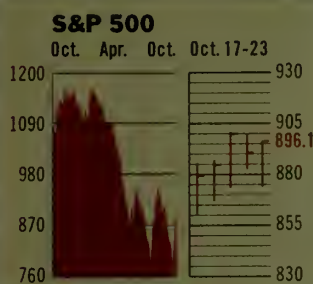
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Stocks



COMMENTARY

The stock market continued its upward march for the second week in a row as positive third-quarter profit results hit the headlines. Earnings for Standard & Poor's 500-stock index companies that have reported so far are showing 10% growth over last year, according to First Call. For the week ending Oct. 23, the S&P gained 4.2%; the NASDAQ rose 7.1%; and the Dow gained 5.7%.

Data: Bloomberg Financial Markets
Reuters

U.S. MARKETS

	Oct. 23	Week	% change Year to date	Last 12 months
S&P 500	896.1	4.2	-21.9	-17.4
Dow Jones Industrials	8494.3	5.7	-15.2	-9.1
NASDAQ Composite	1320.2	7.1	-32.3	-22.5
S&P MidCap 400	428.4	4.6	-15.7	-5.8
S&P SmallCap 600	193.6	5.5	-16.6	-4.6
Wilshire 5000	8430.5	4.2	-21.3	-15.7

SECTORS

			% change Year to date	Last 12 months
BusinessWeek 50*	572.6	2.4	-21.6	-19.9
BusinessWeek Info Tech 100**	280.2	7.0	-33.2	-25.7
S&P/BARRA Growth	465.5	3.5	-21.7	-16.5
S&P/BARRA Value	427.4	5.0	-22.6	-18.9
S&P Energy	185.5	0.5	-12.2	-12.5
S&P Financials	304.5	3.5	-14.3	-9.2
S&P REIT	85.8	-0.9	-8.1	-2.0
S&P Transportation	170.0	1.2	-13.7	-1.7
S&P Utilities	88.4	9.6	-39.4	-43.4
GSTI Internet	75.4	4.9	-28.1	-14.0
PSE Technology	443.4	8.0	-35.5	-25.9

*Mar. 19, 1999=1000 **Feb. 7, 2000=1000

BEST-PERFORMING GROUPS

	Last month %	Last 12 months %
Internet Software	66.0	Casinos 49.8
Semiconductor Equip.	28.3	Homebuilding 47.1
Wireless Services	27.2	Metal & Glass Containers 46.8
Biotechnology	25.5	Managed Health Care 34.1
Photographic Products	24.5	Internet Software 30.2

GLOBAL MARKETS

	Oct. 23	Week
S&P Euro Plus (U.S. Dollar)	787.2	-1.1
London (FT-SE 100)	4006.9	-1.1
Paris (CAC 40)	2992.2	-2.1
Frankfurt (DAX)	3015.4	0.1
Tokyo (NIKKEI 225)	8714.5	-1.1
Hong Kong (Hang Seng)	9804.7	3.1
Toronto (S&P/TSX Composite)	6335.2	2.1
Mexico City (IPC)	6000.6	1.1

FUNDAMENTALS

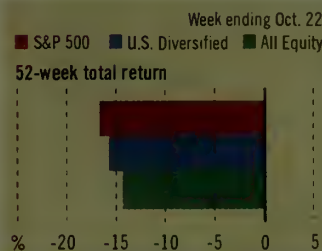
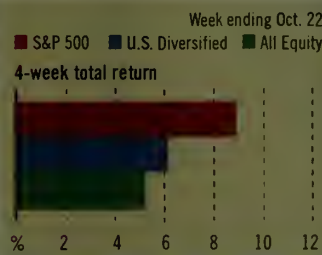
	Oct. 22
S&P 500 Dividend Yield	1.76%
S&P 500 P/E Ratio (Trailing 12 mos.)	29.7
S&P 500 P/E Ratio (Next 12 mos.)*	16.2
First Call Earnings Surprise*	2.99%

*First Call Corp.

TECHNICAL INDICATORS

	Oct. 22
S&P 500 200-day average	1012.5
Stocks above 200-day average	20.0%
Options: Put/call ratio	0.76
Insiders: Vickers NYSE Sell/buy ratio	1.44

Mutual Funds



Data: Standard & Poor's

EQUITY FUND CATEGORIES

4-week total return	%	52-week total return	%
Leaders		Leaders	
Communications	10.7	Precious Metals	47.0
Europe	8.7	Pacific/Asia ex-Japan	6.3
Technology	8.6	Real Estate	6.0
Financial	8.1	Diversified Emerging Mkts.	5.5
Laggards		Laggards	
Precious Metals	-13.7	Communications	-38.4
Japan	-6.6	Technology	-36.7
Real Estate	-5.4	Utilities	-29.6
Diversified Pacific/Asia	-3.6	Health	-23.8

EQUITY FUNDS

4-week total return	%	52-week total return	%
Leaders		Leaders	
Rydex Dynam. Velocity 100	28.0	First Eagle SoGen Gold	74.9
ProFunds UltraOTC Inv.	27.8	Tocqueville Gold	63.3
Sm. Barney Telecoms. Income	24.3	Monterey OCM Gold	62.1
Fidelity Select Multimedia	19.9	Gabelli Gold	61.6
Laggards		Laggards	
Rydex Dynam. Venture 100	-27.8	ProFunds UltraOTC Inv.	-62.1
ProFunds UltraShort OTC	-27.7	Black Oak Emerging Tech.	-62.0
Frontier Equity	-19.4	World GenomicsFund.com	-61.3
U.S. Glob. Wrld. Prec. Minls.	-18.7	Rydex Dynam. Velocity 100	-60.8

Interest Rates

KEY RATES

	Oct. 23	Week
MONEY MARKET FUNDS	1.35%	1.3
90-DAY TREASURY BILLS	1.66	1.6
2-YEAR TREASURY NOTES	2.14	2.0
10-YEAR TREASURY NOTES	4.23	4.0
30-YEAR TREASURY BONDS	5.16	5.0
30-YEAR FIXED MORTGAGE†	6.36	6.1

†BancQuote, Inc.

BLOOMBERG MUNI YIELD EQUIVALENT

Taxable equivalent yields on AAA-rated, tax-exempt bonds, assuming a 30% federal tax rate.

	10-yr. bond
GENERAL OBLIGATIONS	3.96%
TAXABLE EQUIVALENT	5.66
INSURED REVENUE BONDS	4.09
TAXABLE EQUIVALENT	5.84

THE WEEK AHEAD

CONSUMER CONFIDENCE Tuesday, Oct. 29, 10 a.m. EST ► The Conference Board's October confidence index probably fell to 90, says the median forecast of economists surveyed by MMS International.

GROSS DOMESTIC PRODUCT Thursday, Oct. 31, 8:30 a.m. EST ► The economy most likely grew at an annual rate of 3.6% during the third quarter.

EMPLOYMENT COST INDEX Thursday, Oct. 31, 8:30 a.m. EST ► Compensation in the

third quarter probably rose 0.9%, after a 1% gain in the second quarter.

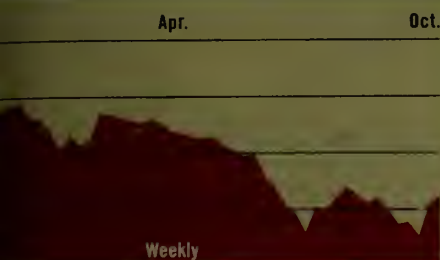
EMPLOYMENT Friday, Nov. 1, 8:30 a.m. EST ► Nonfarm payrolls in October are expected to have increased by 23,000 jobs, after falling by 43,000 positions in September. The unemployment rate probably climbed back up to 5.8%.

PERSONAL INCOME Friday, Nov. 1, 8:30 a.m. EST ► Personal income is forecast to have increased by 0.5% in September,

while consumer expenditures slipped by 0.1%.

PURCHASING MANAGERS' INDEX Friday, Nov. 1, 10 a.m. EST ► The Institute for Management's October industry index probably edged down to 49.5% in September.

CONSTRUCTION SPENDING Friday, Nov. 1, 10 a.m. EST ► Building outlays in most likely slipped by 0.2%, for a straight monthly decline.



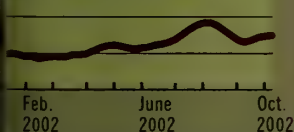
ered gains this week, albeit modest compared to the broader market. A handful of stocks were -digits, including Pulte Homes, Best Buy, and American Electric Power—up 14.1, 12.7%, and ly. Large-cap drug stocks got hit on news of patent concerns and downgrades: Johnson & John- while Pfizer fell 2.8%. WellPoint Health Networks declined 2.5% despite reports of profit gains.

COMPANY PERFORMANCE

% change			% change		
Week	Since 3/1/02	Rank	Company	Week	Since 3/1/02
Johnson	-1.6	-4.8	26 Tenet Healthcare	0.0	31.3
	2.2	-0.4	27 Household International	-4.7	-48.6
	-2.8	-24.2	28 WellPoint Health Networks	-2.5	39.1
	6.2	-16.0	29 Washington Mutual	8.0	9.8
	11.1	-18.6	30 Duke Energy	8.0	-42.9
	11.6	-43.5	31 Kohl's	-3.1	-18.0
	0.6	-10.5	32 Bed Bath & Beyond	8.3	9.5
	3.4	-4.4	33 Cardinal Health	1.6	4.4
	12.7	-51.5	34 Centex	10.1	-17.5
Bergen	1.4	10.3	35 American Electric Power	18.5	-50.3
Group	2.4	38.5	36 Golden West Financial	4.8	8.3
	6.3	-2.8	37 Stryker	-0.6	0.6
	7.0	-39.1	38 Harley-Davidson	1.9	6.5
res	0.8	-7.7	39 PepsiCo	2.4	-11.7
	8.6	-96.6	40 Merck	2.9	-16.3
amics	3.6	-10.4	41 Apache	-1.4	6.3
ps	-0.2	-18.9	42 Amerada Hess	0.1	-4.9
atories	0.0	22.8	43 KB Home	10.5	15.5
	3.8	-9.5	44 First Data	7.7	-16.6
	-4.4	-70.7	45 Tyco International	8.3	-52.1
etroleum	0.5	11.9	46 International Game Technology	7.2	10.5
	5.2	6.3	47 Capital One Financial	14.1	-35.5
	14.1	-7.8	48 Electronic Data Systems	1.3	-76.5
	-1.9	-22.2	49 Nabors Industries	9.4	5.7
	4.8	-16.3	50 Xcel Energy	18.5	-55.6

Production Index

Change from last week: 0.0%
Change from last year: 1.8%
OUTPUT Oct. 12=164.6 1992=100
Index is a 4-week moving average



Index remained unchanged over the calculation of the four-week moving x posted a small decline to 163.6, asonally adjusted basis, steel, lum-ut were all up moderately, with rail- ing slightly and autos almost un- over production and crude-oil refining declines, with truck assemblies also week.

the index components is at www.business-week.com
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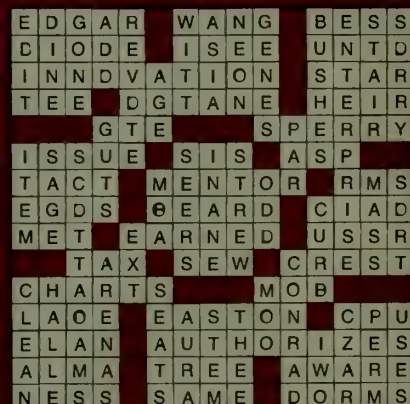
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If the U.S. economy is to start growing again at its full potential, companies will need to restore profits to pay for capital investment and research and development. Despite recent layoffs, chief executives will have to do more to deliver those profits. The tech bubble, the recession, and unprecedented accounting and business scandals have forced CEOs into a defensive crouch. But the brutal truth is that without taking some painful actions, companies won't have the money to expand and compete on the global scene. In the long run, the entire country will suffer.

What will it take? Big reductions in compensation costs—for top management as well as the rank and file. *BusinessWeek* estimates that with sluggish revenues over the next year, companies in the Standard & Poor's 500-stock index may have to cut as many as 900,000 jobs, or 4% of the labor force, to boost profits by 12% (page 106). Significant cuts in outsized executive pay will have to be made as well.

This level of pain may be needed because overcapacity, deflation, globalization, and even technological innovation are all cutting the pricing power of Corporate America. Companies can't raise prices and in many cases are being forced to cut them. More significantly, it turns out that we never truly understood the relationship between productivity and profits. We assumed that a surge in productivity growth would automatically translate into profits. It hasn't. From 1993 to 1997, as productivity began to increase, earnings per share at the S&P 500 companies did jump from \$22 to nearly \$40. But after 1997, productivity

kept rising—but profits didn't. Profits, according to government figures, actually fell 6% from 1997 to 2000 and dropped 10% further in the 2001 recession.

Where did the money go? To a large extent, competition. *BusinessWeek* reckons that managers and employees of the nonfinancial S&P 500 companies took home more than \$100 billion in net proceeds from exercising stock options in 2000 alone, enough to wipe out most of the rise in net operating earnings from 1997 to 2000. This doesn't include regular salaries or other forms of compensation. In a huge transfer of wealth from shareholders to managers and workers occurred.

Shareholders are unlikely to allow a repeat performance. They're already pressing CEOs to run their companies to maximize profitability, not their own compensation or that of their employees. Investors are already demanding that Corporate America move away from a profit-maximizing EBITDA world of anything-goes accounting and focus on quality earnings. All this will make the generation of profits much more difficult in the future.

The government can help some. Extending unemployment insurance could help ease the layoffs, and, for companies, tax credits for investments could shore up earnings. In the end, though, CEOs are going to have to make hard choices. Rebuilding profits, especially quality profits, will take pain. But profits are the lifeblood of a market economy and the key to sustained growth. There's no alternative.

IS WASHINGTON JUST FAKING IT?

We don't get it. Just when investors are beginning to believe in the stock market again, the Bush Administration is undercutting their confidence by subverting corporate reform. The President had a fine start in getting out ahead of the accounting and business scandals with an unexpectedly tough speech on CEO responsibility, but now the Administration is signaling that enough is enough.

Well, it isn't. Investors still feel deeply betrayed by the business fraud and blatant Wall Street conflicts of interest that cost them billions in wealth. The Administration should support a broad-based equity culture over the narrow and corrupt crony capitalism that has done so much harm to the U.S. To do that, it should fully implement the reform measures passed in recent months.

The first sign of backsliding: Republican pressure on Securities & Exchange Commission Chairman Harvey L. Pitt to withdraw his backing for John H. Biggs, former chairman and CEO of TIAA-CREF, to head the accounting oversight board established by the Sarbanes-Oxley Act. Indeed, it was Representative Michael G. Oxley (R-Ohio), a

heavy backer of the accounting industry, who leaned on Pitt to reject Biggs precisely because he pushed for serious reforms. If Pitt caves, it'll seem that Washington just toyed with investors, giving the appearance of reform while undermining real change.

Another sign is the Administration's recent attempt to lowball funding for the SEC. The agency desperately needs to increase staff to properly oversee Corporate America and help prevent a recurrence of this year's wave of scandals. The White House is now saying it is willing to go beyond a \$568 million cap it had proposed. But if that's all it's willing to do its job, the Administration should back the \$1 billion Congress wants to spend on the agency.

An equity culture of widespread stock market participation offers the best path back to growth and prosperity. It rests on investors believing that they can rely on the numbers, that corporate crooks will be punished, that the markets will be open and fair. A strong SEC is needed. The Administration is being shortsighted. Reform needs what investors—and the stock market—needs right now.



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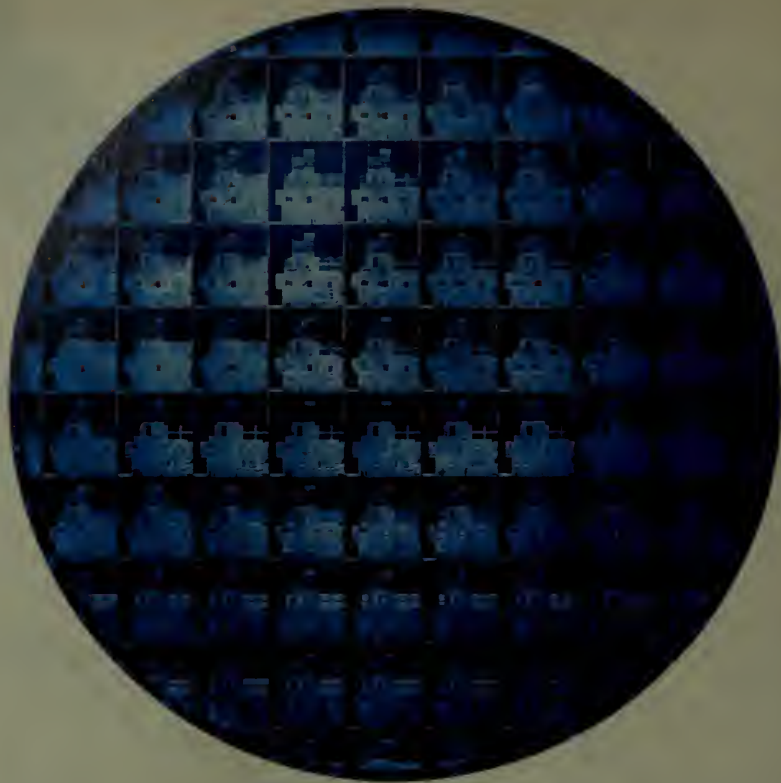
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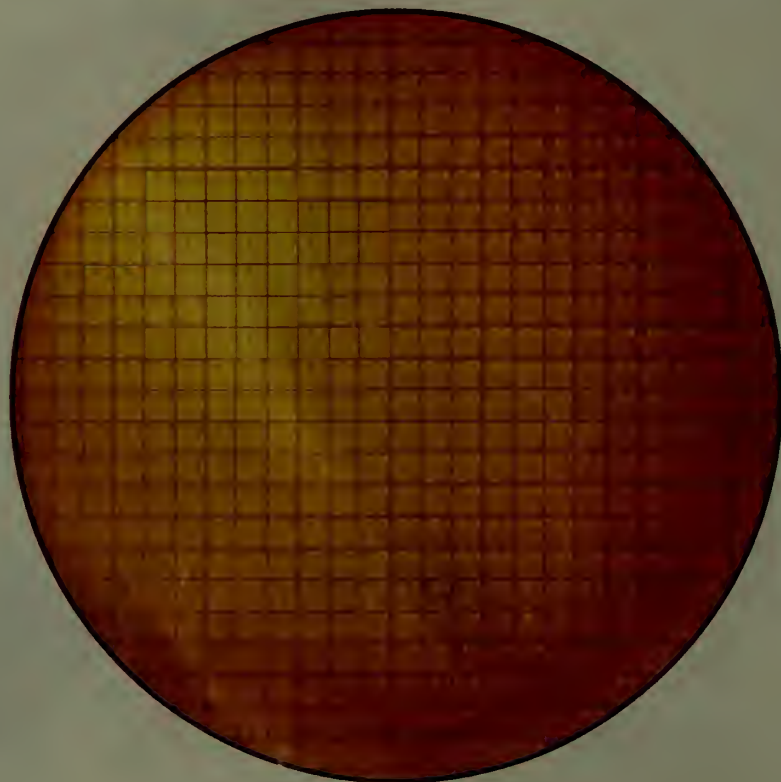
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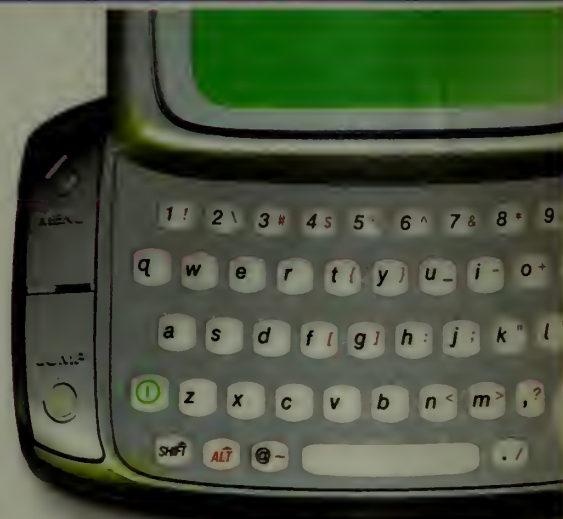


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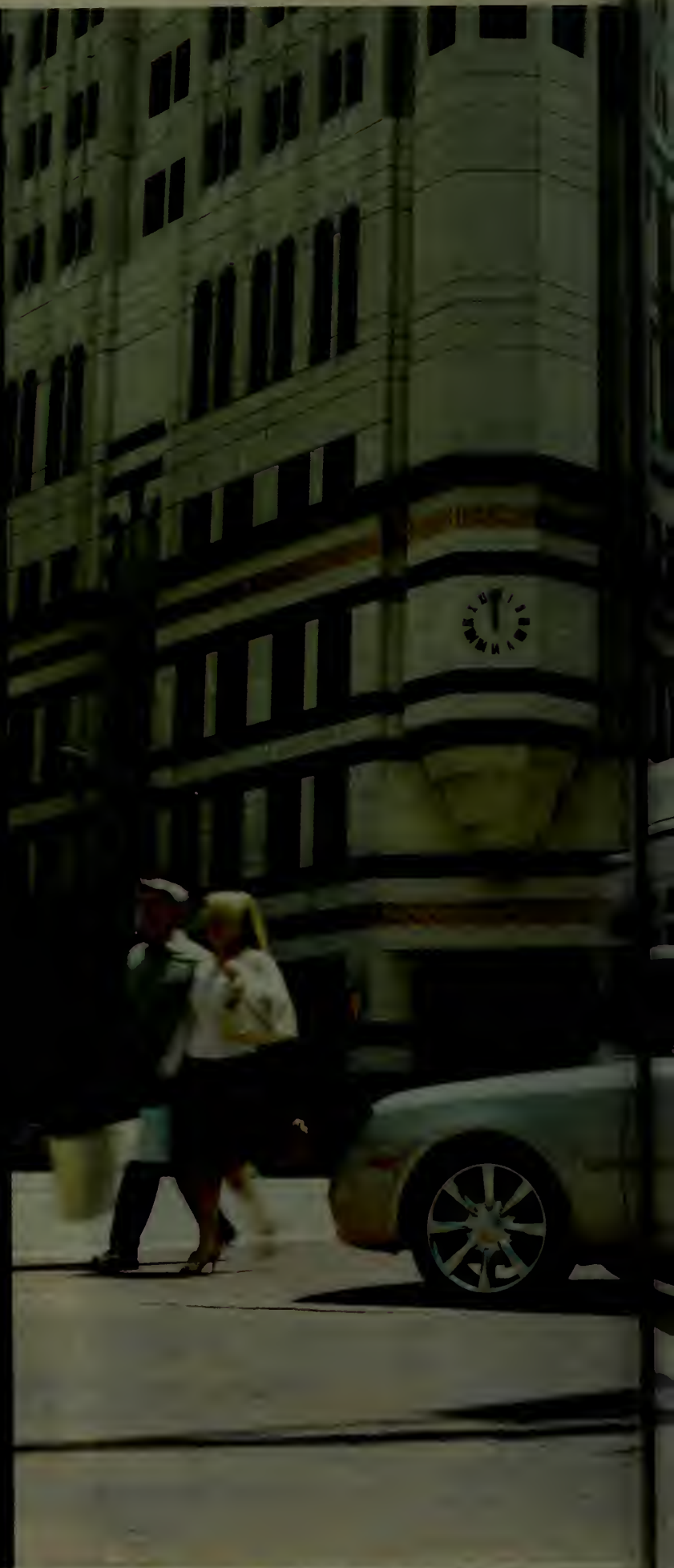
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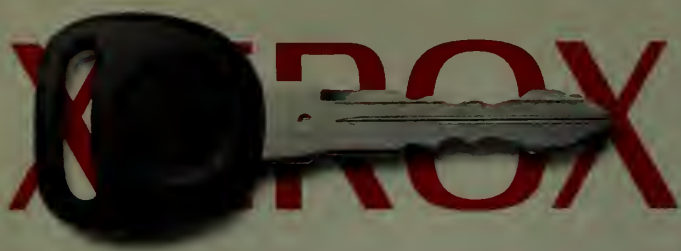
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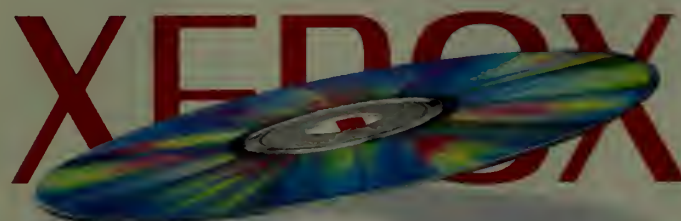
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A Sober View

Corporate America's third-quarter earnings are good, but they're not as strong as they appear at first glance. And that accounts for the sour mood among lots of pros on the Street



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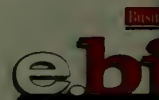
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Webster uses PeopleSoft HCM to manage a workforce of 10,000 employees, including a significant number of part-timers. The company manages its workforce information by supervising and analyzing performance data, which helps it understand its workforce and its needs. "We're able to quickly respond to change. We've already reduced our 75% high grade turnover. That's a huge benefit to our organization. Overall, we're continuing to work with PeopleSoft HCM."

Medallia

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Bank of International

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Up Front

EDITED BY SHERIDAN PRASSO



LITIGATION NATION

FIRST NAPSTER... YOU MAY BE NEXT

THE NEXT BIG BATTLE IN THE copyright wars: Hollywood and the recording industry vs. Corporate America.

In a thinly veiled threat mailed on Oct. 25 to CEOs of the nation's 1,000 biggest companies, four top film and recording industry lobby groups warned that corporations could be liable for breaking copyright laws if employees use company networks to download and store music or movies illegally.

WEIGHTY MATTERS

FEWER PUFFERS, MORE PUFFIES

ECONOMISTS HAVE UNMASKED a surprising culprit in the alarming rise of obesity in the U.S.: the crackdown on smoking and higher taxes on cigarettes—which cause more



LIGHT UP: Keeping the pounds off

smokers to quit. Each 10% increase in the inflation-adjusted price of cigarettes produces a 2% increase in the number of obese people, other things being equal, according

That's no empty threat, says Hilary Rosen, chairman of the Recording Industry Association of America (RIAA), the letter's lead signatory. This serves as "fair warning" that lawsuits could be coming unless the practice stops, the RIAA says. It has documented the rising use of company servers to store stolen music and wants to put a stop to it. High-speed lines make it easier for employees to download Eminem or the Dixie Chicks at work instead of at home. Says Rosen: "This has shown itself to be an increasing problem."

CEOs may want to take heed. The RIAA has racked up some impressive wins against copyright violators, including Napster. Most recently, it scored a \$1 million settlement with Integrated Information Systems, a Tempe (Ariz.) company that had been running a server just for employee music swapping. *Lorraine Woellert*

to economists Shin-Yi Chou of New Jersey Institute of Technology, Henry Saffer of Kean University, and Michael Grossman of the City University of New York. The reason is obvious, they say: "Individuals who quit smoking typically gain weight."

The trouble is, obesity causes even more chronic health problems than smoking, according to a study last year by RAND Corp. That's bad news, considering that the researchers say 23% of Americans are obese, up from 11% in the early 1980s.

"Only a cynic" would conclude that rolling back antismoking measures is the answer to obesity, Grossman says. What's needed instead, he says, is stronger efforts to get people to eat right. *Peter Coy*

TALK SHOW "It's a pretty smelly thing, in my opinion."

—Charles Schwab, characterizing a proposal that Wall Street research be handled by an independent group funded by firms currently being investigated

I-WAY PATROL

E-MAIL: SIGNED, SEALED, DELETED

WHAT HAPPENS WHEN YOU TRY TO REACH AMERICA'S top companies by e-mail? A lot of the time, nothing, say consulting firm CustomerRespect.com, which spent five months e-mailing the 100 largest corporations. A shocking 37% didn't respond at all—not even with automated form letters. It took three days or more for an additional 22% to answer, the study found. Says its author Don Daly: "It was as if they were saying 'Don't communicate with us. Ever.'"

Researchers, who posed as customers, graded companies on the speed and quality of responses, site navigability, and ease in finding privacy policies. Overall, retailers did well (table). But results varied widely within industries. In this version of the Pepsi Challenge, Coca-Cola won hands-down—19th place vs. 97th for Pepsi. "We are making changes as we speak," says PepsiCo spokeswoman Elaine Palmer. Top place Freddie Mac had fast, detailed responses.

Last-place Ingram Micro, a large tech distributor, didn't respond to e-mail and buried its privacy policy Daly says. Ingram's Jennifer Baier says the company customers—mostly tech resellers—have password-protected sites unavailable to outsiders. "Our corporate is not a fair representation" of how Ingram responds, she says. Fair enough, but maybe the study will make companies think twice—and respond. *Arlene Weintraub*



THE LIST ONLINE, BUT PLUGGED IN?

Of the 100 largest U.S. company Web sites, here are the

MOST RESPONSIVE

1. FREDDIE MAC
2. COSTCO WHOLESALE
3. DUPONT
4. ALLSTATE
5. LOWE'S
6. VERIZON COMMUNICATIONS
7. INTEL
8. SEARS ROEBUCK
9. HEWLETT-PACKARD
10. IBM

LEAST RESPONSIVE

1. INGRAM MICRO
2. MARATHON OIL
3. PEPSICO
4. PFIZER
5. UNITED TECHNOLOGIES
6. MERCK
7. GOLDMAN SACHS
8. LOCKHEED MARTIN
9. BERKSHIRE HATHAWAY
10. J.P. MORGAN CHASE

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WIRED LIFE

WHO NEEDS ADS WHEN YOU HAVE E-MAIL?



HE'S A SELF-STYLED POPULIST WHO takes on Republicans, gun-toting conservatives, and those who don't share his left-leaning views. He's also one heckuva pitchman. In between talk-show appearances, documentary filmmaker Michael Moore has been e-mailing an estimated 100,000 folks a week in what has become one of the most aggressive e-mail campaigns in Hollywood history.

Prompted in part by a missive from Moore that starts: "Dear friends, fans and fellow evildoers," moviegoers have spent more than \$2.6 million to see his latest film,

Bowling for Columbine, which examines America's violent shootings and questions its gun laws. The take is impressive since the film opened on Oct. 8 in only eight theaters. MGM is now expanding it to 150. In the years since Moore first struck a nerve with his 1989 film *Roger & Me*, he has developed the art of e-mail promotion, says his sister and spokeswoman, California lawyer Anne Moore.

He took to the Net in 1995 when Fox Entertainment wanted to cancel his show *TV Nation*, she says, noting that more than 50,000 faxes prompted by Moore's posted entreaties rolled in, giving the show a few more months of life. To promote his film—and his irreverent best-seller *Stupid White Men...and Other Sorry Excuses for the State of the Nation*—Moore taps his Web site, MichaelMoore.com, which he says logs 17 million hits a month, up from 70,000 earlier this year. The site urges such action as preventing "Bush's war" in Iraq and asks folks to sign up for his e-mail list. "Mike's a populist guy, and e-mailing is a populist way of communicating with them," Anne says.

This isn't the first time a small film has appealed to Netizens. This year's surprise hit, *My Big Fat Greek Wedding*, which benefited from an e-mail blitz by Greek Americans, has grossed nearly \$178 million and is still going strong. That's a target Moore can only dream of. *Ronald Grover*

THE BIG PICTURE

WHO'S MORE FIT?



DRAWN & QUARTERED



SECOND ACTS

BLOWING BLUE CHIPS OFF THE ROAD

BATTERED BY THE STOCK market and afraid of a housing bubble, investors are taking some of their money for a spin in an altogether different type of investment: collector cars. Despite a sorry economy, this market has been growing about 10% annually, to \$1 billion this year.

And it looks as if it will keep motoring on. America's largest collector-car auction, the Barrett-Jackson sale in Scottsdale, Ariz., in January, which attracts 150,000 people from 19 countries, is already turning away cars for sale. The number of people signed up to bid is up 60% over this time last year. Craig Jackson, who runs the auction, is heartened by the interest—and the fact that 66% of his recent sales at other auctions are in the \$20,000 to \$75,000 range. In contrast, most money in the early '90s was chasing the highest-priced cars. He credits collector cars' rising popularity to nostalgia, the stability of

the investment, '56 T and the fact that A so it's, well, "fun." vestr

Jackson offers this advice to newbie b First, decide what kind you'd like to take for a day drive, then research history, including whet has its original engine.

Looking for the equi of a blue-chip stock?



'31 BUGATTI ROYALE

Mustang vertible Thunderbird are cars big appeal that also are tiful enough to keep below \$60,000. Those v bit more cash can hunt one of the six 1930 Bugatti Royales for up of \$12 million.

Yet it's muscle cars are all the rage. Built i troit in 1964-71, they relatively small bodie their supersize motors. C 1970 Chevrolet Chevelle vertible, sold at auction year for \$172,000. Not return on a car that \$3,200 new. *Nanette B*

Polls, surveys, and other items for consideration in this section should be sent to upfront@businessweek.com

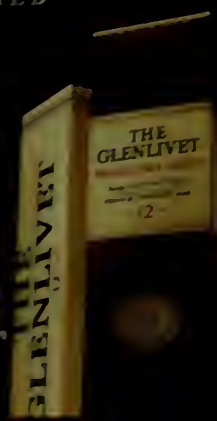


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A NEW PLAYER ON OUR TECH TEAM

From its inception, *BusinessWeek* has been in the forefront of reporting the impact of technology on business and on our lives. We pioneered coverage of the fledgling information technology industry in the 1960s with a regular feature, *Computers & Communications*, which was devoted to ferreting out the newest technical advances and what changes they might bring. We have been expanding our coverage ever since.

Seven years ago, we broadened our approach to offer advice and information to tech buyers who were facing a dizzying array of choices. Our first annual Technology Buying Guide, on Nov. 6, 1995, focused primarily on computers, but it quickly expanded beyond PCs, laptops, and printers to all manner of technology—from cell phones and wireless communications to the high-tech fads of the moment such as cybervisors (so 2001).

Now, there's a new member of our team: CNET Networks Inc., a leading provider of technology information on the Web. Our eighth annual Technology Buying Guide combines the insight and recommendations of the *BusinessWeek* staff with rigorous product testing provided by CNET's crew. We think the two teams complement one another and will make our joint effort

an even more valuable shopping tool. You can see the results for yourself inside—rankings and reviews and the special selection of hot products.

For many additional recommendations—visit our Web sites, *BusinessWeek Online* (businessweek.com) and CNET.com. You'll find views of individual products written by CNET's talented staff members, as well as up-to-the-minute price information. You can also see some of the products and reviews featured in our buying guide on *BusinessWeek*

TV. For local listings and times, visit businessweek.com/bwtv.

This year, there's even more to our annual compendium of what's hot. We've added a new section of technology products for entertainment and leisure. We call it The Digital Home. *BusinessWeek* and CNET have tried out everything from home networks that are easy to understand to digital cameras that produce shots even the pros would send to their mothers.

We think you'll like this year's of productivity and personal tools all starts on page 129.

Stephen B. Shepard

Editor-in-Chief



1995: Buying Guide 1.0

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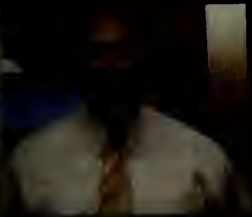
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LEAN

(YES, WE'RE TALKING ABOUT YOUR SUPPLY CHAIN.)



Brown streamlines your supply chain from top to bottom. Gone are the warehouses you had to run, the fulfillment problems you had to solve, the transportation you had to manage. All you have left is a lean, fast and efficient supply chain machine courtesy of UPS Supply Chain Solutions. And you thought we just delivered packages.



Readers Report

WHAT THE B-SCHOOL ISSUE LEFT OUT

One statistic missing from "The best B-schools" (Cover Story, Oct. 21) is their dropout rates. With graduation virtually guaranteed and an inflation in programs (executive, evening, etc.), 20% of graduates will pound the pavement for years to come as long as the hardest part of business school is the getting-in.



not only produce graduates who are more likely to succeed (i.e., land a job) but would also attract more women and other underrepresented groups.

Segev Tsifti
Rockville, Md.

Your issue on B-schools is incomplete. *BusinessWeek* must also rank the schools that turn out the most effective swindlers. Index the officers and directors of the 1,035 companies that cashed in \$66 billion worth of stock before the market tanked, and find out, of those holding MBAs, where they were educated. From such a ranking, a potential offender profile could be generated and perhaps used to some effect.

D. Patten
Boston

B-school rankings of "student happiness" and placement, based on the dean's push and alumni pull, may lead to another round of misplaced priorities. B-school programs, like any other business process, should be evaluated on the basis of "economic value added," input-output ratio, or return on total investment—and not on relationship networks and undue favors. Let the difference between the market value of inputs and the market value of outputs indicate the efficacy of the process used to prepare proactive, self-reliant business warriors capable of fending for themselves in the global business arena.

Trilok N. Sindhwani
New Delhi

It was gratifying to see the University of Chicago's Graduate School of

Business make it back to No. 1. What's up with the cover? You have No. 1, No. 3, and No. 4 representing full regalia, but no Chicago. Miscellaneous: Couldn't find a Chicago GSB student clean sweatshirt?

Brad Ch...
T...

THE VIEW FROM THE TOP OF CITIGROUP'S BOARD

Citigroup does not belong on the table "Boards that need work" (best & worst boards," Cover Story 7). As you note, we have taken tant steps to ensure that our board adheres to the highest standards of corporate governance, including announcement on Oct. 1 that I eliminate interlocking directorships.

At 16 members, Citigroup's board of directors is not too big; the fact that we need a large board to provide the attention and review required, given our company's size and complexity. Although we have never had a problem with our audit committee, whose members have devoted the time necessary to ensure rigorous review of our procedures and results. As you noted, Citigroup's board "is loaded with top-flight talent" and the ones you mention all sit on the audit committee.

Sanford J. Jaber
Chairman and CEO, Citigroup
New York

FASB: GETTING THE FACTS STRAIGHT

I want to try to correct some of the and mischaracterizations of the Financial Accounting Standards Board in "The reform behind closed doors" (Editorial, Oct. 21). First, FASB is not, as you state, "the accounting industry's maker." We establish financial reporting standards for U.S. public and private companies and not-for-profit entities. We do not set standards for the accounting or auditing industries.

Second, the particular vote you refer to occurred at the June, 2002, meeting of the Emerging Issues Task Force (EITF), a group that addresses specific emerging practice issues in financial reporting under the oversight of the FASB and the SEC staff. Contrary to the implication in the editorial, all meetings of the EITF are open to the public. People can observe the meetings in person or listen in via a dial-in facility. Likewise, our board meetings are also open to the public.

Also, contrary to the implication

orial, the EITF did not "kill" dis- of the particular matter. While I yet a member of FASB at the that June EITF meeting, my und- ing is that, based on the vote cussion at the meeting, it was that the issue warranted fur- udy. That study has now been ed and the issue will be dis- again and hopefully resolved at t EITF meeting on Oct. 25. has initiated reforms aimed at ng the timeliness, effectiveness, ceived independence of standard- including more direct involve- y FASB in the agenda, delibera- and conclusions of the EITF.

Robert H. Herz
Chairman, FASB
Norwalk, Conn.

IS NO PIE-IN-THE-SKY TMENT

l it the wrong stuff" (Science & ogy, Oct. 14) correctly hit all the ssues that are facing American ace. I would add just one more All of the problems we are facing mptoms of a basic problem—the federal investment in aerospace. current budget is a hair over olion. At the funding peak of the program in the mid-1960s, NASA ceiving just under \$30 billion in money. I can assure you that a funding trend has impacted our y space efforts, too. t stands, aerospace is the largest e [contributor to the] balance of n American manufacturing. This t continue without increased in- ent. Many other countries are in- g heavily in their own aerospace . We in the U.S. must do the Our strategic and economic in- s are at stake.

Dave Weldon (R-Fla.)
House of Representatives
Washington

's note: Weldon represents Flori- ith District, where Cape Canaver- ocated.

CAN EAT RIGHT DONALD'S

your rush to demonize McDonald's ou left some helpful facts off your ("Why we're so fat," Marketing, 21): Only 5% of our customers e to supersize anything; the typical nald's customer visits our restau- about twice a month; McDonald's een giving customers comprehen- nutrition information since 1973; uality food is right-sized for all from Happy Meals to Extra Value ; you can eat three times a day at

McDonald's and still meet Agriculture Dept. nutritional guidelines; and Mc- Donald's has sponsored physical fitness programs and nutrition education for decades. McDonald's takes nutrition very seriously. Too bad *BusinessWeek* readers were fed supersize clichés instead of facts about our menu.

Walt Riker
Vice-President, Social Responsibility
& Communications
McDonald's Corp.
Oak Brook, Ill.

NOT NECESSARILY THE VIEWS OF THE MANAGEMENT

I would like to add a simple disclaimer to my letter published under the heading "Here's to productivity," (Readers Re- port, Oct. 21). My letter does not repre- sent the official position of my employer, the Bureau of Labor Statistics.

Joel A. Claghorn
Economist, Industrial Price Div.
Bureau of Labor Statistics
New York

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THE CONQUERORS

Roosevelt, Truman and the Destruction of Hitler's Germany, 1941-1945

By Michael Beschloss

Simon & Schuster • 377pp • \$26.95

LAYING THE FOUNDATIONS OF A NEW GERMANY

At the end of World War II, as the Allied powers assumed control of Germany from a shattered Third Reich, General Dwight D. Eisenhower declared: "The success of this occupation can only be judged fifty years from now. If the Germans at that time have a stable, prosperous democracy, then we shall have succeeded." By this definition, the conquerors achieved their goal. But according to Michael Beschloss' new account of behind-the-scenes intrigue and chaotic decision-making, the triumph of the American Presidents—aided and abetted by Britain's Winston Churchill, complicated by the scheming and paranoia of the Soviet Union's Joseph Stalin—was as much an accident as it was the grand design of policymakers.

The colorful, larger-than-life figures in *The Conquerors: Roosevelt, Truman and the Destruction of Hitler's Germany, 1941-1945*, are familiar to us all, since a surfeit of material is already available on the World War II era. The challenge for a historian is to carve a distinctive niche in the literature on the period. And while Beschloss—a high-visibility TV presence who wrote two fascinating volumes on Lyndon Johnson's White House tapes—labors mightily, he doesn't altogether succeed.

The author has unearthed a trove of previously unpublished documents, but his slim volume suffers from a misguided focus on Treasury Secretary Henry Morgenthau's ill-fated blueprint for the radical economic restructuring of Germany. Morgenthau aggressively pursued a controversial proposal to turn post-Hitler Germany into an agrarian nation, something ultimately dismissed by Harry Truman as "that crazy plan." With 60 years of historical distance, Morgenthau's idea looks laughably naive.

The book's concentration on Morgenthau (the only Jew in Franklin D. Roo-

sevelt's viciously anti-Semitic Cabinet) leads Beschloss to make several tactical mistakes. There's an inordinate amount of attention given to often-boring Administration debates over the economy of Germany, from the Ruhr Valley factories to the Kiel Canal. Meanwhile, Beschloss does not devote enough time to discussing how the U.S. planned to build democratic institutions, de-Nazify a nation full of Hitler's brainwashed subjects and true believers, and reeducate the nation so that Germany would never again pose a threat to the world. And as Beschloss showers attention on Morgenthau, whose own secretly recorded conversations and private papers he reviewed, the author neglects to tell us what was going on in the minds of FDR and Truman.

The Allies faced the dual challenges of crushing the Axis militarily and of considering how best to govern the postwar world. Yet Beschloss talks little of Allied military strategy in Europe—other than the immoral decision not to bomb the Nazi death camps. (Even after Eisenhower and others described the horrors of the Holocaust, FDR's anti-Semitic Secretary of War, Henry Stimson, continued to refer in his diaries to "so-called atrocities.")

Still, despite its shortcomings, *The Conquerors* should not be dismissed. It effectively captures Roosevelt's well-documented ability to play off one top aide against another. The eminent historian James MacGregor Burns (Beschloss' former teacher at Williams College) famously subtitled his biography of Roosevelt "The Lion and the Fox." Beschloss is describing the lion in winter. As the war with Germany is reaching its cli-

max, the American President is apart before our eyes. He is we by severe weight loss and unable centrate. Meanwhile, he is guard his fiercely protective daughter. When he repudiates a contro memo from the State Dept. that earlier initialed, Roosevelt says h remember ever seeing it. No one sure whether the once-great lead playing the sly fox or the dying li

The author also shows how, Churchill's warnings, both Roosevelt and Truman were taken in by Stalin. he looked forward to the postwar said that "perhaps during Stalin's ing for the priesthood, 'something tered into his nature of the

Christian gentleman behave." And Truman Potsdam, described St "honest, but smart as He was half-right.

Indeed, Truman and sevelt seemed to mis stand Stalin's postwar While U.S. policy were engaged in inter bates over the demilition and deindustrial of Germany, Stalin pushing for dividing F into Soviet and E

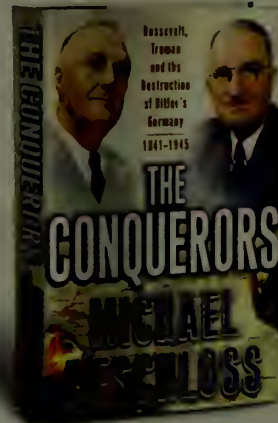
spheres of influence. (Churchil have emboldened Stalin by telling that the U.S. didn't plan to be i rope for long after Hitler's defe Yalta and Potsdam, the U.S. Pres unwittingly gave Stalin at least approval for his westward expan

Considering the many miscalc by U.S., Soviet, and British leade amazing that things turned out s in Germany. Then again, in try avoid the punitive excesses tha lowed World War I, Roosevelt an man allowed Stalin's Iron Curtain scend. The conquerors may well avoided a third world war with many. But the cost was the Cold

Beschloss says he decided to this book in 1991, just two weeks the demise of the Soviet Union. In Eisenhower's reflection about the post-Hitler Germany can now be a to postcommunist Russia. It will be future historians to judge whether I passes Eisenhower's test.

BY RICHARD S. DU

Dunham covers the White F



THE ALLIES' STRATEGY WAS A HUGE SUCCESS. WAS IT GRAND DESIGN—OR HAPPY ACCIDENT?

AMD

I don't want to
work harder. I want
to work smarter.

AMD
me.

AMD Athlon™ XP processor is fast. **Very fast.** And fortunately, speed is just beginning. This processor is about more than just megahertz. Its unique design results in more work per clock tick, giving your computer a more efficient way to work, and you, a smarter way to work. Think of it as true performance. It's just one more way AMD designs and builds processors with you in mind. We always have. We always will. To learn more about AMD's true performance, ask your IT department or visit www.amd.com

BOOK BRIEFS

INTERNATIONALIZING CHINA

Domestic Interests and Global Linkages

By David Zweig

Cornell • 291pp • \$45 cloth, \$22.50 paper

WINDS OF CHANGE

In any state-controlled economy, bureaucrats usually fight greater openness because it tends to erode their powers. Yet uniquely in China, local bureaucrats have actually accelerated the opening up of the country that Communist Party elites first embraced in 1978. Just how and why grassroots officials bought into the profound transformation and how the central government often lost control of the process are the subjects of David Zweig's detailed *Internationalizing China*.

Zweig examines a series of cases—focusing on rural opening, economic development zones, overseas study, and the struggle to control development assistance—to show how things transpired. In each situation, what the cen-

tral authorities had intended to be gradual openings developed into feverish land grabs, as local officials rushed to seize opportunities before the reform window swung shut. Quickly shedding their communist ideology, low- and mid-level officials from towns, schools, and state agencies vied for such spoils as junkets abroad or increased chances for promotion. Language skills and foreign connections, "which under Mao had made people political targets," became keys to success. Meanwhile, with each opening, the central government lost another lever of control. China's development, argues Zweig, came to depend upon local bureaucrats' "ability to manipulate or evade centrally erected barriers to global transactions."

Corruption became commonplace, particularly in special economic zones, where limits on lavish banquets, gifts, and cars were suspended in the name of going along with "international customs." The author observes that, in a one-party state, there is no institution-

alized opportunity for popular force posed to corruption to emerge, either the press or from outraged citizens.

This book is not for everyone: Zweig's writing is often dense and academic. But it contains much valuable information and analysis. For example, Zweig shows how the 1980s Bang reforms that proved so damaging in Latin America and Eastern Europe. Zweig's study is also a warning to those in the West who might imagine that China's new opening is going to lead inevitably to political reform. The author believes that

international trade and foreign investment, instead of fostering a more realistic political system, have strengthened the hold of the Party by giving it more material resources. Over time, it seems that the Chinese experience will prove that an authoritarian state can open its economy to international trade without either collapsing or becoming more democratic.

BY MARK L. CLIFFORD

THE FALL OF ADVERTISING & THE RISE OF PR

By Al Ries and Laura Ries

HarperBusiness • 295pp • \$24.95

THE END OF ADVERTISING AS WE KNOW IT

By Sergio Zyman with Armin Brott

Wiley • 239pp • \$27.95

TUNING OUT ADS?

This fall, many on Madison Avenue are feeling sanguine about the prospects for TV advertising, the default choice of big marketers. Demand for airtime is brisk. And worries that viewers will get siphoned away by the Internet—or learn to bypass ads with the aid of personal video recorders—seem to be receding into the future.

Two books have arrived just in time to damp the good vibes. One is by Coca-Cola Co.'s former marketing chief, Sergio Zyman, who is now a consultant, and the other is by Al Ries and Laura Ries, a father-and-daughter consulting team. In different ways, both volumes attempt to upend the tenet that advertisements—and expensive TV spots in particular—are the indispensable foundation of marketing.

Both books make a simple point: The efficacy of advertis-

ing has been dulled by media clutter and consumer cynicism. "Advertising has no credibility with consumers, who are increasingly skeptical of its claims and whenever possible are inclined to reject its messages," the Rieses declare in *The Fall of Advertising & the Rise of PR*. Zyman makes the same point, in a more pugnacious tone, in *The End of Advertising As We Know It*.

Even if the message is no longer entirely novel, it is noteworthy to have authors such as these deliver it. In Zyman's role as Coke's "Ayacola" in control of an immense marketing budget, he not so long ago represented the elite within the marketing Establishment. As the consultant who popularized the idea of "positioning" brands for different consumer segments, Al Ries has probably wielded even more influence over marketers' thinking. When movers of such stature start exhorting companies to put fewer eggs in the ad basket, it suggests that a fundamental rethinking is under way.

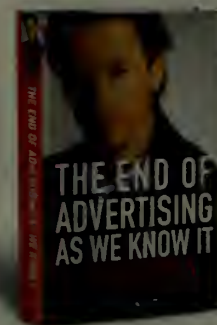
Unfortunately, both books are a mite slapdash. Polemical in nature, they bludgeon readers with heated rhetoric and repetition. But the examples provided are inconclusive.

Moreover, the authors tend to misstate the objectives of the companies they misguidedly ad campaigns they create. In some cases, they simply get the facts wrong.

So if massive ad budgets no longer are the way to build brands, what do the authors recommend? Zyman provides an informal primer on other elements of marketing, from packaging to celebrity endorsers. The Rieses' prescription is simply to employ better relationships. For them, PR eclipses anything that can generate word of mouth. Citing companies as Starbucks Corp. and Amazon.com Inc., the Rieses argue that ads are rarely effective in building a brand, although they can play a role in sustaining an established brand. Zyman's image-building ads that don't contain a clear sales proposition, that's just wrong without a hook."

Both books are pungent, but rarely persuasive. To take just one example: Ads clearly were a prominent part of the Amazon.com launch. The Rieses never satisfactorily explain why PR deserves the credit for the success. Still, if the books prompt companies and their agencies to reconsider how they spend precious marketing dollars, both sides will be better off.

BY GERRY KHERM



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BY STEPHEN H. WILDSTROM

tech&you@businessweek.com

AOL AND MSN: NEW, BUT BARELY IMPROVED



The latest versions of the leading ISPs offer attractive, but minor changes

By the time a product reaches version eight, the odds are good that a new release will not bring revolutionary change. So for all the hoopla surrounding AOL 8.0 from America Online and MSN 8 from Microsoft, these new versions of the two top Internet access packages are evolutionary steps. Each includes features that will be attractive to current customers, but neither offers people a compelling reason to abandon their existing service.

AOL 8.0 focuses on keeping the service's 35 million members happy and giving them a reason to stay with AOL as they gradually move from dial-up access to broadband. AOL offers high-speed access through several DSL carriers and its corporate sibling, Time Warner Cable, for \$54.95 a month. Bring-your-own access customers, who already have broadband, can subscribe for \$14.95 per month; unlimited dial-up is \$23.90. AOL maintains its traditional approach, providing lots of chat rooms, discussion groups, e-commerce, and information sources within the service's "walled garden." Broadband users get additional content, such as movie trailers (especially from corporate sibling Warner Bros.) and many channels of music on Radio@AOL.

Microsoft's latest offering is the umpteenth overhaul of MSN, which has been bleeding money for eight years. The newest MSN will be mostly a paid service. MSN.com will continue to exist as a free portal, but MSN Explorer software, a simplified version of the Internet Explorer browser, will now be available only to subscribers. MSN, too, is promoting broadband with the introduction of more video. Microsoft offers broadband access for \$39.95 to \$49.95 through Verizon and Qwest DSL and Charter Communications cable. Bring-your-own access is \$9.95; unlimited dial-up is \$21.95. While there is some exclusive Microsoft content, including the Encarta encyclopedia, MSN

is still much more of a portal to general content than is AOL.

This reflects the fact that, while AOL appears to compete head-to-head, they are really going after different market segments. AOL's target is a less tech-minded customer who values safety and simplicity above sophisticated advanced features and who views an AOL subscription as membership in a community. Microsoft's target is a more tech-savvy customer, kept reminding developers, "at AOL, money always comes first." Microsoft puts more emphasis on technology and less on warm fuzzies.

The difference between them shows in two areas: mail and personalization. AOL 8.0's e-mail is all but unusable, but unlike the typical AOL member doesn't have to delete 250 or more messages a day. An AOL mail has three fixed folders—new mail, old mail, and junk mail—because AOL execs decided to keep it simple. There are no user-configurable filtering capabilities.

"Neighborhood Watch" will pop up when you receive a message from someone not in your address book. The address book also contains a "junk" page—just in case that image might be objectionable. (The feature planned for next year, code-named Photon, will allow AOL users to delete their messages through standard mail programs like MSN, by contrast, has enhanced the program. It's the Web-based pro-

gram it has shared with Hotmail in favor of a simplified version of Outlook Express with a wealth of user options. For example, it lets you create personal mail filters to automate message handling. MSN also offers junk-mail control more effective than AOL's. And unlike AOL, which simply discards mail it deems junk, MSN saves it for inspection in its own folder.

AOL 8.0, again in the interest of simplicity, offers minimal personalization of your home page. Users can choose one of six preset page layouts featuring varied combinations of news, sports, and entertainment. MSN lets you customize just about every feature of the home page. It also offers glitzy features, such as letting users in different locations browse the same Web page together.

Both services offer many of the same functions, from Web browsing to parental controls (a longtime area of AOL strength where MSN has caught up). If I had to choose, I'd go with AOL, but that's not to say it's better. This is a case of different services for different customers, and choice is good.



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BY JEFFREY E. GARTEN

DON'T LET THE CEO RUN THE BOARD, TOO



TWO JOBS:
Separating
the posts of
CEO and
chairman
removes a
slew of
conflict
issues. And
doesn't the
CEO, an
employee,
need a boss?

Jeffrey E. Garten is dean of the Yale School of Management. A former investment banker, he is the author of *The Politics of Fortune* (jeffrey.garten@yale.edu).

Despite sweeping new legislation and a more aggressive Securities & Exchange Commission, effective reform of corporate governance comes down to the performance of boards of directors. Some recent progress aside, these boards still have much to do. One imperative is for them to separate the often-combined positions of chairman of the board and chief executive. While such a separation goes against U.S. corporate traditions, where power is commonly concentrated in one person, it is standard practice in Canada, Britain, and Continental Europe. And in the post-Enron environment, it is an idea whose time has come for our companies, too.

When the CEO also runs his company's board, a number of fundamental conflicts of interest can exist. It is much more difficult for a board to monitor a chief executive's performance and hold him accountable for results if the CEO is also the chairman. This is why so much emphasis has been placed by Congress, regulators, and shareholder groups on having board members with no financial or significant business ties to the companies they oversee. But independent directors alone won't suffice.

Andrew S. Grove, who is chairman of Intel Corp., while Craig R. Barrett is its CEO, made the point to me this way: "The separation of the two jobs goes to the heart of the conception of a corporation. Is a company a sandbox for the CEO, or is the CEO an employee? If he's an employee, he needs a boss, and that boss is the board. The chairman runs the board. How can the CEO be his own boss?" In a recent survey of board members from 500 large U.S. companies, McKinsey & Co. found similar views. Nearly 70% of respondents said a CEO should not run the board.

There is another, perhaps more important reason to separate the roles. Some 80 million Americans own stock in companies today, many of them depending on the income for retirement or their children's education. Chairing a board has therefore become a far greater public fiduciary responsibility. It is also a full-time job. It's not plausible to expect one person to successfully run a major company in an increasingly risky and hypercompetitive global economy and also do everything a good board chairman should do—setting the board agenda, ensuring the board gets the highest quality information, and facilitating communications both among board members and between them and management.

To understand the full scope of the chairman's

job, read *Corporate Governance and Chairmanship: A Personal View*, a new book by Sir Adrian Cadbury, who chaired Cadbury Schweppes PLC between 1975 and 1989. He shows how the jobs of chairman and CEO require different skills and temperament and explains why the chairmanship itself, when done well, is a far more demanding and specialized job than Americans generally appreciate.

Attorney Ira M. Millstein, who has chaired boards as diverse as General Motors Co. and Walt Disney Co., adds another point. "CEOs need to be comfortable taking educated risks," he says of me. "At many critical junctures, a CEO needs his board to stand behind him. The more independent the board is, the more significant support will be. A separate chairman adds to that support and credibility."

To be sure, most of Corporate America supports this idea. I have heard highly regarded CEOs such as Lawrence A. Bossidy, recently retired from Honeywell International Inc., say that creating two jobs out of one risks that two people vie for control, with adverse effects on the company's strategy and execution. But the point to companies such as AOL Time Warner Inc., where the chairman-CEO separation prevented deteriorating performance or tattered governance. But there are counterexamples, too—great corporations such as Toyota, BP, and Nestlé that have split the two positions and built institutions with substantial long-term values.

New York Stock Exchange Chairman and former CEO Richard A. Grasso told me he opposes the idea of separating the top two jobs, favoring instead an independent lead director who would meet with each board meeting with just the other independent directors. But the arrangement is unusual, given the responsibilities and the time commitment involved. After all, no matter how constructive and intense periodic discussions with other directors are, they constitute just one part of managing the board. There are, of course, serious issues to consider. Should a retiring CEO become the chairman or would an outsider be better? How should a chairman be compensated? Under what circumstances should a board move its chairman? Answers would have to be tailored with experience.

Fundamental in any system of government, public or private, is the concept of checks and balances. The American CEO-centric system of corporate oversight lacks too much of it to make time for a change.

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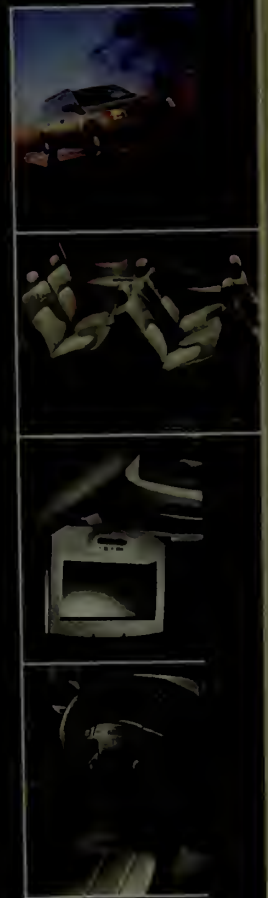
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BY GENE KORETZ

INDEX FUNDS AND INEFFICIENCY

Why S&P 500 stocks perform so well

What's the safest, most reliable way for people to make money in the stock market? Most economists would probably advise investing in an index fund such as those whose portfolios mirror the Standard & Poor's 500-stock index. Indeed, Burton G. Malkiel of Princeton University notes that the in-

JOINING THE S&P 500 HAS PAID OFF BIG



dex has outpaced the annual return of the median mutual fund over the past 10, 15, and 20 years by about two percentage points.

The usual explanation for this performance edge, note Randall Morck and Fan Yang of the University of Alberta in a recent study, is that the market is highly efficient in determining a stock's appropriate value. And because prices at any particular time tend to reflect all of the available information about a company's prospects, predicting their course is a mug's game. Better to invest in a widely diversified index fund with low fees and transaction costs.

What intrigues Morck and Fang, however, is that the superior relative performance of index funds seems to have also been enhanced by a growing market inefficiency—a price effect related not to economic fundamentals but simply to a stock's membership in the S&P 500 club. As a result, beating the S&P 500 may have been even harder than efficient-markets theory suggests.

It's common knowledge that a company's stock tends to jump on the news that it will be added to the S&P 500 index—presumably because of a surge in demand as index funds add the stock to their portfolios. If the market is efficient, the effect should be temporary.

Yet several studies find that it persists.

Morck and Yang throw light on this debate by using a common valuation measure dubbed "Tobin's q ratio," which is a company's stock market value relative to its book value defined as the replacement costs of corporate assets. They find that both relatively recent and longtime S&P stocks have higher valuations by this measure than comparable stocks not in the index.

Further, the price edge enjoyed by S&P stocks widened over time in line with the growth of S&P 500 index funds. From 1994 to 1999, for example, as index fund assets soared from \$21.3 billion to over \$235 billion, the average S&P 500 stock's premium grew from 18% to 100% of per-share book value.

The authors conclude that the increasing popularity of index funds ironically has created a market inefficiency that has artificially raised S&P 500 prices above the levels dictated by economic fundamentals. In so doing, it threatens to interfere with the key function of financial markets—getting investors to put their cash into the most economically promising investments.

From this perspective, notes Morck, today's bear market may be contributing to market efficiency. As investors have found that owning an index fund doesn't exempt them from risk, money has begun to flow out of index funds, and the S&P premium has started to decline. "If fund outflows accelerate," he says, "it could shrink a lot more."

WHERE ARE THE E-BARGAINS?

Discounts have been waning

The dampening impact of the Internet on retail prices has diminished, reports economist Joseph T. Abate of Lehman Brothers Inc. In recent years, he notes, more than 100 of the smaller, more aggressive dot-com discounters have bitten the dust, leaving the field to larger, well-capitalized e-tailers.

The reduced competitive climate is reflected in Lehman's annual August e-tailing survey. This compares online prices (including shipping costs) of more than 100 items ranging from toothpaste to hardware with the prices of identical items in New York City area stores.

The survey shows that online prices over the past year have risen faster than overall inflation, with the average discount for nonapparel items down to just 2.6%. Big discounts showed up in

only three merchandise categories: ing (56% cheaper), prescription (20.5%), and toys (12.2%).

In the case of apparel, Lehman cludes that the Net may be evolving into an inventory-clearing mechanism. For other products, the shrinking advantage may reflect the value it holds place on the convenience and selection of Net shopping. But even as counts are declining, says Abate, ease of comparing prices via the Net has an ultimately deflationary effect.

THE U.S. FINALLY PAYS THE PIPER

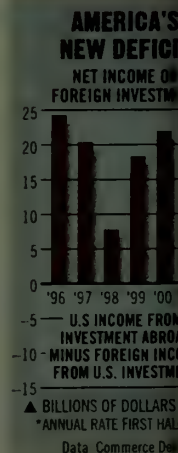
Foreign debt is becoming a burden

It's an intriguing anomaly. The U.S. became a huge debtor nation during the 1990s. Yet until this year it actually received more income (interest, dividends, etc.) from its direct investments overseas and holdings of foreign financial assets than foreigners received from their U.S. investments. Indeed, although the U.S. last year owed foreigners \$1.1 trillion more than they owed the U.S., it still managed to chalk up a \$14.1 billion investment income surplus.

Why hasn't the U.S. had to pay the piper till now? One reason may be that a lot of recent direct foreign investment in the U.S. has faced big startup costs. Investment by U.S. companies overseas is older, so it earns higher returns.

This year, however, the U.S. is suffering a net-income outflow running at \$14.5 billion annual rate. That suggests that America's new deficit could worsen sharply as foreign companies start to earn more from U.S. affiliates. But Harvard University economist Robert Lawrence notes that much of recent foreign investment may have been in highly inflated U.S. companies and stocks. Foreign companies may be plagued by low rates of return for some time.

Low returns for foreigners wouldn't be all good news. As economist Martin N. Baily has observed, foreigners whose recent U.S. investments have soured are less likely to be willing lenders to America in the future.



MES C. COOPER & KATHLEEN MADIGAN

THE FED MAY BE GETTING A BITCHY TRIGGER FINGER

amid uncertainty and global woes, a rate cut might not help much

U.S. ECONOMY

In a sudden turn of market sentiment, expectations of a rate cut by the Federal Reserve before the end of the year have risen sharply in recent days. The action could come as early as the policymakers' Nov. 6 meeting, given the current downdraft in economic activity that began in late summer and early autumn.

Based on futures contracts for the federal funds rate—the Fed's policy tool—market players are now betting that the chances of a quarter-point cut at the Nov. 6 meeting are about three out of four, and that a cut of that size by yearend is all but certain. Some analysts even project a half-point reduction.

CONSUMER WORRIES: JOBS, AND STOCKS



OCT. '02
1985=100
Conference Board, Global Insight

The Fed has been waiting for past rate cuts to kick this recovery into high gear. But several factors suggest that their patience is wearing thin. First, the Fed has been poised for action since August, when it changed its view of the outlook to highlight the risks of economic weakness. Second, recent data evince those concerns: Third-quarter economic growth, while solid, was front-loaded, with production, exports, and orders losing ground as the quarter progressed. And as the fourth quarter began, October consumer confidence fell to a nine-year low (chart).

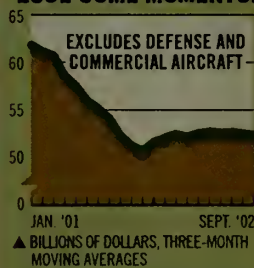
Third, two policymakers voted against the Sept. 24 decision to keep the fed funds rate at 1.75%, preferring an immediate rate cut. One of the dissenters was Governor Edward M. Gramlich, and Fed governors generally do not oppose the position of Chairman Alan Greenspan. With the economy looking worse now than at the last meeting, the dissenters have gained credibility, and sentiment for a rate cut is almost surely broader. Finally, a rate cut would be easily justifiable as low-recovery insurance. Exceptionally strong production growth and stiff global competition, along with the normal lagged effects of a recession, assure that inflation will stay down in 2003, if not slow further. That gives the Fed plenty of time to reverse any additional rate hikes and should economic growth rocket up next year.

USUALLY THE CASE, the Fed will examine the economic data before setting policy. But with uncertainty running high, the Fed will place more weight on in-

dicators of real activity—orders, sales, and output—than on gauges of sentiment that reflect economic angst more than economic reality. Crucially, the Fed will have to decide if the current slowdown is a temporary period of softness caused by corporate hesitation after the summer's new uncertainties. Or is it the start of renewed stagnation or outright recession?

To be sure, businesses have pulled back (chart). Industrial production fell in August and September, inventories were cut further in August, and the trickle of hiring earlier in the summer came to a halt in September. The 5.9% plunge in September durable goods orders also fueled concerns of further layoffs. Plus, orders for capital goods, excluding the volatile defense and commercial aircraft sectors, fell 6.6%, suggesting new weakness in capital spending (chart). But as long as overall demand keeps growing even modestly, chances are high that businesses will become confident enough to gear up again by yearend and into 2003.

CAPITAL-GOODS ORDERS LOSE SOME MOMENTUM



THAT'S WHY THE OCTOBER PLUNGE in both major gauges of consumer confidence to 1993 levels raises the ante for the Fed to act soon. Consumers have been the economy's driving force this year. With businesses already freezing up, if the plunge in confidence indicates consumers are throwing in the towel as well, then it could be a tough winter for the economy.

After the University of Michigan's sentiment index fell, the Conference Board's index slid 14.3 points in October, to 79.4, undoubtedly reflecting fears over the job markets, Wall Street, Iraq, and maybe even a dollop of national angst over the sniper shootings.

The steepness of the October drop is worrisome, but whether it translates into an outright retrenchment in spending remains to be seen. Remember that, from its September 11 plunge until May, 2002, the confidence index rebounded by 25 points. Since then, news of corporate scandals, the stock market slide, and fresh war worries pulled the index down by 30 points. Even so, consumers kept spending, and labor market conditions were fairly stable.

Indeed, housing demand has not suffered, despite

the sag in confidence for the future, which home buyers must have before making such a major financial commitment. Sales on both new and existing homes rose in September, with new-home demand at a record annual rate of 1.02 million. However, through mid-October, mortgage applications to buy a home were trending downward, and so the upside potential for housing to drive economic growth in coming quarters is waning.

ONE OF THE MOST POSITIVE IMPACTS of further rate-cutting by the Fed would be its resonance around the world. In particular, a U.S. cut would put pressure on the European Central Bank to ease policy. Growth in the euro zone has almost ground to a halt in the fourth quarter, with rising fears that Germany could be slipping back into recession. But the ECB shows no inclination to cut rates with areawide inflation of about 2.2%, which is above the ECB's target level.

With the ECB holding its policy rate at 3.25%, real policy rates in the 12-nation region are about a percentage point higher than those in the U.S. More important, with inflation in Germany at only 1%, the ECB is forcing exceptionally high real rates on Germany at a time of acute economic weakness (chart).

Indeed, a strong case is emerging for a coordinated global easing of economic policy, says a study by Global Insight Inc., an economic consulting firm formerly known as DRI-WEFA. The company prescribes a series of

global policy measures on interest rates, tax spending, and estimates their impact would percentage points to growth in the Group of nations in 2003 and an additional 0.8 points. Amid a growing possibility of global stagnation or deflation, the study argues that the risks of such are much smaller than the danger of doing not

But while Fed action might spur foreign central banks, the Fed faces a dilemma at home: Lower borrowing costs cannot address the economy's current softness if that weakness reflects hesitation caused by domestic and international uncertainties. The Fed also risks using up its rate-cutting ammunition that might be needed later on if the economy's slump drags on. However, if the Fed urges patience even while the data remain weak, it will be under increasing attack for not acting sooner.

In this highly unusual business cycle, driven by investment bust and a slew of unique institutional and geopolitical forces, Fed policy has been bold and timely. Now, after 11 months of holding rates steady, policymakers have to sit down and answer a key question: Have their past actions been enough?



INDIA

A DIRE COMBO: DROUGHT AND POLITICAL CONFLICTS

India's economy, the third-largest in Asia, has chugged along this year. But on Oct. 29, the nation's central bank decided to take out some growth insurance by cutting interest rates.

The Reserve Bank of India reduced its policy target, the bank rate, by a quarter-point, to 6.25%, and trimmed its repurchasing rate by the same amount, to 5.5%. In the accompanying midyear report, the RBI lowered its forecast for real gross domestic product growth to 5% to 5.5% for fiscal 2003, which ends next March, from its April expectation of 6% to 6.5%.

The RBI noted that India's economy has been growing strongly.

Real GDP rose at an annual rate of 6.2% in the first half. The economy has benefited from low interest rates, fiscal stimulus in the form of infrastructure spending, and good export growth. Industrial production in August was up 5.7% from a year ago.



But, the RBI said, the severe drought is hammering agricultural production, which accounts for a quarter of economic output. Rainfall from the monsoons is off 19%, and the government

reports reservoirs are down 25.4% from their year-ago levels. In addition, rising inflation had become a growing concern, although the RBI played this worry down in its report. Third-quarter

consumer prices were up 3.2% from a year ago, and higher energy and food prices mean inflation will rise further. Finally, the tensions with Pakistan over the Kashmir region could boil over if the U.S. becomes preoccupied with its own attack on Iraq.

A more structural problem is the political opposition to privatization of such industries as telecommunications and airlines. Politicians worry about the loss of patronage jobs, so they are trying to stop the progress made by investment Minister Arun Shourie. But while halting the process would help job levels in the short run, the opposition will undermine India's move toward becoming a bigger economic power in world markets.

With Manjeet Kripalani in Bombay

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REFORM: SLIP SLIDIN' AWAY

A viable proposal to curb conflicts on the Street remains elusive

This is it—the high tide of financial reform. It should be pay-back time for shareholders who have lost trillions of dollars partly because of greedy executives, crony accountants, conflicted research analysts, and duplicitous investment bankers. It is the moment when legislators and regulators should be restoring confidence in Corporate America by punishing the crooked and building bulletproof systems to prevent the same thing from happening again.

So why does it feel as if the moment is slipping away? After almost a year of crusading against corrupt corporate practices, regulators are throwing together oversight boards to cure the ills that ailed corporate ethics during the heady bull market of the 1990s. But the boards' effectiveness looks highly questionable even before they start.

The Securities & Exchange Commission has appointed a new accounting watchdog made up mostly of people with no track record in accounting (page 37). Meanwhile, New York Attorney General

Eliot Spitzer, along with the SEC and other regulators, is fine-tuning a proposal to resolve Wall Street's research woes. Insulating analysts from pushy bankers would also create an independent oversight board with a five-year, \$1 billion budget funded by investment banks. The board would force banks to give retail investors reports from 20 independent search outfits alongside their own. But critics get a closer look at Spitzer's plan, it, too, looks increasingly unwieldy.

So far, only the regulators fully embrace it. Even before Spitzer and SEC Enforcement Director Stephen M. Cutler put the final touches on their proposals, investors, independent researchers, and industry veterans are dumping them. Investors doubt that forcing big banks to hand out independent research will bring shame in-house analysts into honest recommendations. Independents complain that their own research may be compromised if they accept money from banks. And industry veterans think the reforms don't go far enough. On Oct. 29, Charles R. Schwab, chairman and co-CEO of discount brokerage Charles Schwab & Co. branded Spitzer's proposal "ludicrous." He told financial advisers in Washington: "It looks like one more thing done by a coup of crafty investment bankers."

Indeed, the bankers are now ste

ELIOT SPITZER

Investors, researchers, and industry veterans say his reforms just don't go far enough

CLEANING UP

THE ENFORCERS

THE PLAN New York Attorney General Spitzer, the SEC, and other regulators want to strengthen rules to insulate analysts from investment bankers. A new oversight board will also force banks to give retail investors reports from 20 independent research outfits alongside their own.

THE FINANCING Banks will contribute to a \$1 billion five-year budget to fund the independents' research. But big

banks are haggling over the bill. Independent search outfits say it's chump change.

THE PROBLEMS Banks still want analysts' help in deciding which companies to underwrite. Moreover, little is known yet about how the board will function, who will sit on it, and how closely it will monitor the quality and accuracy of research. Worse, low fees and the perception of being tainted may keep good research outfits from joining.

tors' thunder. On Oct. 30, Citigroup need it will separate research from investment-banking unit, pair it with all brokerage business, and hire 37-year-old research hotshot Sallie L. Krawcheck, CEO of independent researcher Sanborn Bernstein & Co., to run the new unit to be called Smith Barney. "There is to be a major change in the way this business is going to be conducted in the future, and we accept that, and we appreciate that," Citi Chairman and CEO Sandy Weill told *BusinessWeek* (page 36). "It's very important that people have confidence in this system."

Citi's proposal doesn't undermine regulatory's new roadmap. Weill says he plans to work along with regulators' recommendations. But Citi's announcement has put all of their noses out of joint. "It would matter if the banks' responses came through the negotiating room, not the back channel," says one.

Some rival bankers consider Citi's proposal more form than substance. They think Citi, like all banks, will stop analysts consulting with bankers on deals if regulators order them to. They think Citi's plan is designed to help Citi, who is being questioned as part of Spitzer's probe of Citi. Weill told *BusinessWeek*: "If our competitors think [our plan] is nothing, God bless them!"

Previously, regulators abandoned the idea of spinning off research because they were convinced it would be a bad idea, bringing massive layoffs, and a bad choice for investors. Now, they believe the rules to give research separate compensation, supervision, evaluation, and compliance structures can solve the problem. John C. Coffee Jr., professor of securities law at Columbia University, says the trick will be to "get independent research out of the hands of investors without messing up with a reform that is so protective that it starves the field of securities research."

On Oct. 30, banks and regulators lined up at odds on several issues.

TREET

CITIGROUP

R Research analysts will be separated from investment banking in a separate unit to be called Smith Barney, headed by Chairman and CEO Sandy Weill. They'll be joined by 12,500 retail analysts in a unit overseen by newly hired research hotshot Sallie L. Krawcheck.

FINANCING Smith Barney will be funded by fees from the private client and institutional investors. Citi says the unit will be profitable,

Banks are bickering over how to split the \$1 billion bill for Spitzer's plan. Says one source close to the talks: "Firms will be unwilling to pay hundreds of millions of dollars if they don't know what other penalties the SEC has in mind or what the states plan to do."

No wonder retail investor groups are skeptical. They fear the net result of the flurry of reform proposals will be same old, same old. "What's going to happen is that [brokers will say], 'Here's this plain-vanilla, unbiased report I have to give you. But then there's this other one that really says what I mean,'" says John D. Markese, president of the American Association of Individual Investors in Chicago. "I don't think we're changing anything, frankly."

Surprisingly, independent research firms are even more critical. In theory the biggest beneficiaries of Spitzer's plan, many are skeptical—especially since they weren't consulted. They worry that if investment banks subsidize their research, they, too, could become contaminated. "It's a system that might eventually taint independent research," says Scott C. Cleland, chairman of the Investors' Research Assn.

It's even unclear if there are 20 firms that cover enough stocks well enough to fit the bill. Most focus on a couple of hundred U.S. companies, while major firms cover thousands of them globally. Worse, independents that line up for funds may not be the best qualified. Under the plan, the oversight board can pay an average of just \$10 million a year to 20 firms. That's unlikely to tempt the best, who charge as much as \$40,000 a year for their reports. "I don't think you're going to get any of the upper-echelon firms," says Steve Leuthold, chairman of Minneapolis-based Leuthold Group.

Some firms want to keep their focus on money managers, not retail investors. Recently, BNY JayWalk Inc., a Bank of New York subsidiary that resells independent research, yanked 35 firms from a Web site for retail investors. President John D. Meserve said it was too time-consuming to explain repeatedly to clients that they

but if the research it provides isn't stellar, in-house asset managers won't want to pay for it.

THE PROBLEMS Citigroup's reputation in research has been badly tarnished. Krawcheck will have to shift analysts' focus from earning banking fees to serving clients, enforce tough new standards, and defend her unit's independence. She will also have to determine how much contact analysts and bankers can have.

SANDY WEILL

Critics say Citi's plan is more form than substance and designed to get Spitzer and his investigators off Weill's back



couldn't afford the expensive research.

The makeup of the oversight board proposed by regulators might bring some clarity. Sources close to the talks say names such as Paul A. Volcker, the ex-Federal Reserve chairman, and Felix Rohatyn, ex-managing partner of Lazard Frères & Co., are being floated as candidates to head the board. For now, Rohatyn, who has not been contacted, has reservations. "I'm still not clear in my own mind how this structure would work," he says. Rohatyn thinks it will

still take draconian measures, such as spinning off research, to truly rid Wall Street of its conflicts. "You can set up all sorts of internal controls and safeguards, but I just don't believe that Chinese walls work," he says. Volcker couldn't be reached for comment.

Ironically, Spitzer's plan may benefit investment banks—by cutting their costs sharply. Research costs big Wall Street houses \$800 million a year each. By paying the likes of Salomon Smith Barney telecom analyst Jack Grubman \$20 mil-

lion a year to help bankers win banks "created for themselves a cost of doing business," says Trone, a securities-industry analyst at Prudential Securities Inc. "It would be good for the industry if regulators took the cost out of the system." But it would be if they fail to bring investors and a quick fix proves popular only to regulators and banks.

By Emily Thornton, with Heather Timmons and Mara Der Hovanesian in New York, and Geoffrey Smith in London

REWRITING THE RULE BOOK AT CITI

For over six months, Citigroup has been besieged by investigations into research done at its Salomon Smith Barney investment bank. Citi took reform into its own hands on Oct. 30 when it said it would separate research from investment banking. Its analysts will be paired with SSB's 12,500 retail brokers, and the whole unit will be run by Sallie L. Krawcheck, until now the CEO of independent research shop Sanford C. Bernstein & Co. A former securities analyst, Krawcheck was known for her critical comments about Citi predecessor Travelers Group and the other financial giants she covered. BusinessWeek banking editor Heather Timmons spoke with Krawcheck and Citigroup CEO Sanford I. Weill about the new structure:

How exactly is this new business model going to work?

SK: We'll get fee-based revenues from the private-client side and trading revenues and commissions from the private-client and institutional-investor side. The costs for research will come out of that. The business will stand alone as a profitable unit within Citigroup. But the real difference is that our research will have a client focus. The analysts are working for the private clients and the institutional investors, full stop.

That will be a cultural shift for SSB's research unit. How will you do that?

SK: I think a mind shift is already taking place. The analyst community has been sullied by some of the things that happened during the bull market, but 99% of these folks are highly ethical individuals who have a great



SANDY AND SALLIE: Krawcheck arrives with a reputation for toughness

deal of responsibility to their clients.

This plan goes further than the settlement being negotiated by the states and SEC. Will it supersede those talks?

sw: What we've set up can, and will, accommodate and integrate any plan put out by the regulators. We understand the need for change, we understand the need to restore investor confidence, and we think we've been addressing that.

There are still some big unknowns. Will analysts be allowed to do due diligence for IPO underwriting, for example?

sw: We are willing to do anything that will be part of the industry settlement with the regulators, and that goes from zero interaction to some interac-

tion. There is going to be major change in the way this business is conducted in the future, and we accept that, and we applaud that, because it is very important that people have confidence in the system. Our country is the best in the world, and we have to get it going again.

For this division to have any integrity, Sallie, you are going to have to be comfortable turning to Sandy at some point and saying, "No, we're not going to do things that way." Are you?

sw: She was telling me how to do this business before she even worked here.

SK: This is not an organization of people. These are not easy personalities. There are vigorous debates going on in here, and that's a very appealing quality to me. Sandy and I had spats in the past, and we're going to have them going forward.

SK: Uh huh.

“There is going to be a major change in the way this business is conducted”

SANDY WEILL

COMMENTARY

By Mike McNamee

ACCOUNTING WATCHDOG—OR LAPDOG? HERE'S HOW YOU'LL KNOW

this any way to restore public confidence in corporate America—financial integrity? The Securities & Exchange Commission was poised to establish a strong, independent board to oversee accountants, raise the quality of auditing. Instead, the contentious and politicized process of choosing members of the new Public Company Account-

Oversight Board (PCAOB) has created doubts about the group's credibility and capability. Four of the five picks—including the board's chairman, William H. Webster, the former FBI and CIA director—have no public track record on accounting.

It's hard not to conclude that this board was designed to be a weak underling for SEC Chairman Harvey Pitt. That's good news for accounting firms: Pitt appears to worry about shielding auditors from their own mistakes.

But investors have plenty to fear. The new oversight board—the centerpiece of Washington's response to a terrible year of corporate scandals—could quickly become captive to the accounting industry. Public attention for the PCAOB is bound to wane, as bewildered investors lose interest in the board's increasingly technical decisions. The Final Four accounting firms, however, aren't going away: Their potent lobby will always be ready to push its views on the board.

How can investors tell whether the PCAOB is working for or against

them? A few key issues should signal whether this board intends to be a real watchdog:

■ **Staffing and resources.** With just six months to get organized, the PCAOB must quickly design an organization from scratch and hire key staff. The accounting lobby will be happy to offer blueprints and candidates—but the board needs to strike out on its own. A tough enforcement chief is vital: The board should set its sights on a former top SEC enforcer, such as William R. McLucas, now with the law firm of Wilmer, Cutler & Pickering. It also should charge companies fees that are high enough to support a robust operation.

■ **Inspections.** Less visible but just as important is the inspection department—the group that will examine the Final Four firms annually to make sure they have strong quality controls. The accountants will lobby for a small inspection team that contracts out its work—recreating the current system of peer reviews. Yet it was that back-scratching scheme that let Deloitte & Touche give Arthur Andersen high marks—even

as Enron, Global Crossing, and other Andersen clients were tanking. Clearly, the oversight board must build its own team of strong, independent inspectors.

■ **Audit standards.** The biggest fight will be over audit standards, the rules that say how auditors go about verifying companies' books. Now,

those rules are set by a committee of the American Institute of Certified Public Accountants (AICPA). The CPAs are fighting to keep control. But even the profession's own panels admit that the current rulebook is full of holes. A 2000 report to the SEC said that auditors should provide much more documentation on how they decide to sign off on a company's books. The

CPAs rejected that, fearing that better records will leave a paper trail for shareholder lawyers.

There's only one correct response: The PCAOB should take over audit standards and write tougher rules that protect the public, not CPAs.

The PCAOB is not the only place investors need to watch. At the SEC, Pitt plucked out the Enforcement Div.'s chief accountant, Charles D. Niemeier, to serve on the board. "If Pitt hires a replacement who's friendly to the big firms, it will be disastrous," warns Douglas R. Carmichael, professor of accounting at Baruch College. Enforcement has been one bright spot in the SEC's response to corporate scandal.

And then there's the SEC itself. After a 3-2 party-line vote on Webster, the commission will have a hard time pulling together a consensus as it oversees the accounting board. Pitt got the board he wanted. But the longer he pulls its strings, the less investors will trust it—or the markets it's supposed to heal.

McNamee covers the SEC.

The oversight board was supposed to reassure investors spooked by corporate scandals. Now that seems less likely



TOP COP

Ex-FBI and CIA Director Webster, the PCAOB's first chairman, has no accounting experience

THE ECONOMY

THE NEW ECONOMY'S NEW AUSTERITY

Now corporate honchos focus on squeezing more out of their capital investments

It was practically an article of faith during the go-go years of the New Economy boom: The path to increased productivity and higher profits lay in stepped-up corporate capital spending, especially on computers and other information technology.

Well, a funny thing happened on the way from boom to bust. Corporate capital outlays collapsed as demand headed south and the economy fell into a recession. Even now, with the recovery more than three quarters old, capital spending remains stuck in the doldrums.

But productivity gains are anything but dull. Over the last year, productivity has soared by 4.8%, a stellar performance even by the standards of the boom years. The rapid rise has Alan Greenspan, Federal Reserve chairman and productivity guru, scratching his head. "We at the Federal Reserve are struggling to account for so strong a surge," he said in a speech on Oct. 23.

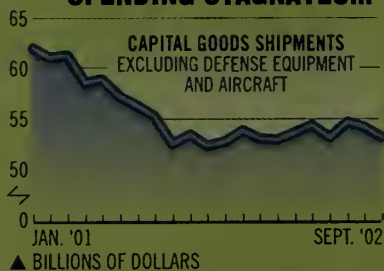
Part of the answer, undoubtedly, is good old-fashioned cost-cutting: paring workforces and eliminating corporate fat. During the roaring '90s, companies padded payrolls and added layers of management. With those halcyon days over, they have cut back sharply. Just look at General Motors Corp: It has cut salaried staff by 10% in each of the past two years to 40,000, boosting efficiency.

But something else is at work as well. Stung by a steep fall in profits over the last two years, corporate honchos are taking a much more hard-headed approach to investment outlays, even as demand has picked up and profits have improved. With capital-spending budgets tight, they're concentrating on squeezing ever more out of the investments they have already made. "The world has changed," says John A. McKinley Jr., chief technology officer at Merrill Lynch & Co. "We're in an era of austerity."

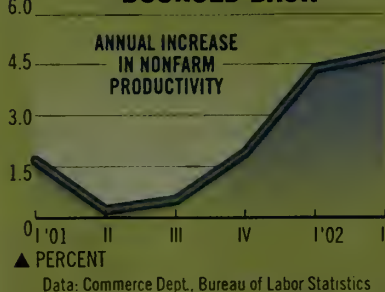
Call it spending better, rather than spending

more. Company chiefs are demanding quick payouts from their investments. And they're pressing underlings to make do with what they have by learning to work their existing plants and factories more efficiently. "It's a more-with-less approach," says H. John Riley Jr., chief executive of Cooper Industries Ltd., the Houston-based maker of electrical products, tools, and hardware.

DOING MORE WITH LESS EVEN AS CAPITAL SPENDING STAGNATES...



...PRODUCTIVITY HAS BOUNCED BACK



Data: Commerce Dept., Bureau of Labor Statistics

Of course, no executive worth a check is about to stop investing in business or cease spending on IT equipment. Even now, during a capital-expenditure bust, companies are shelling out \$1 trillion a year in investment. And the uncertainties about Iraq and corporate scandals clear and the economy up, there's no doubt they'll stop spending. Moreover, with companies to use the equipment they have to productivity, they should be willing to buy plenty more once the replacement cycle plays out.

But the new, more sober approach to corporate execs to capital investment could mean that the upturn will be muted than many of the more optimistic economists expect. "It will pick up," Martin N. Baily, a productivity expert who headed up the White House's Council Economic Advisors under Bill Clinton. "But budgets are going to be more closely supervised than they were in the '90s."

The reason is simple: Today's tightening has taught execs that they can get a lot more out of their investment than they had been getting in spending splurges are unlikely until they see the end of such gains. At Price-



n Inc., improved software is all the Norwalk (Conn.)-based online auctions site to push its computer tasks harder. Its computers now run tasks as much as 500% faster than As a result, the company has d some capital spending and reded some servers for other uses. got more out of the existing ma- and infrastructure we already says Chief Information Officer V. Rose.

only New Economy companies rning new tricks. In the last three Avery Dennison Corp., a \$4 billion of labels and bar-code tags based sadena, Calif., generated 50% r production of some of its lines h better set-up and scheduling. e added capacity without having nd capital," says Chief Financial Daniel R. O'Bryant.

he post-bubble world, companies ling that bite-sized bits of IT spend- upgrades and other enhancements re efficient than massive tech buys past. Research by Chicago Fed ist John G. Fernald and Susanto and the University of Michigan's w D. Shapiro suggests the disrup- caused by the frenetic pace of capi- estment reduced annual productiv- wth by about a half percentage uring the latter half of the '90s, as and workers raced to keep up. he spending spree slowed, there ver costly disruptions. That alone, search suggests, may have boosted ctivity growth by about a quarter tage point over the past year.

uller-is-better is clearly the strategy icalty-materials producer Engel- Corp. "The big programs always a huge amount of capital and res- in a short period of time—and one I've looked at delivers less han anticipated," says CEO Barry W. Perry. Instead, Engelhard began what Perry calls a three- to five-year "just-in-time IT en- ment program," a series of piece- plant-by-plant upgrades.

tough-minded approach isn't good for high-tech companies looking return to glory days. And, short it means the hoped-for return of robust capital spending isn't yet on the horizon. Still, in the long run, such pragmatism can't be anything but good for America's productivity and prosperity.

By Rich Miller in Washington, with Faith Keenan in Boston, Christopher Palmeri in Los Angeles, Ira Sager in New York and bureau reports

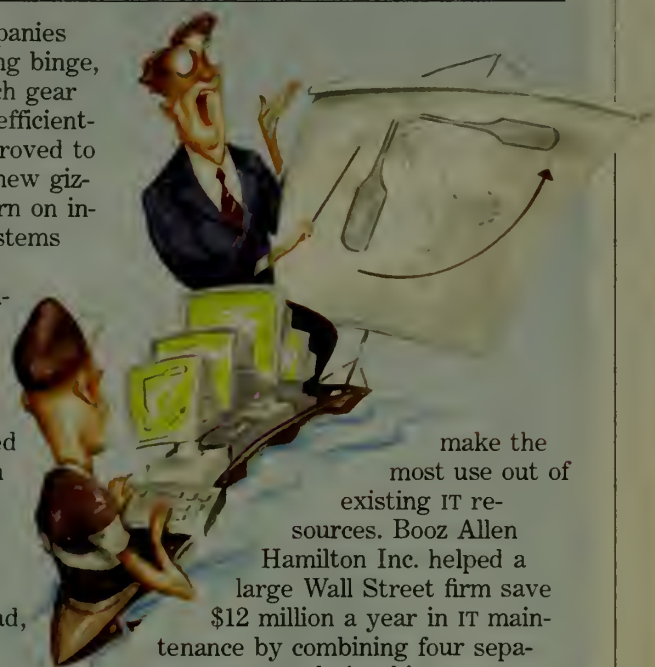
TODAY'S TECH MANTRA: REDUCE, REUSE, RECYCLE

In the late 1990s, U.S. companies went on a technology-buying binge, shelling out millions for tech gear to run their businesses more efficiently. Many of those purchases proved to be big disappointments—the new gizmos often provided little return on investment. Redundant tech systems drove up licensing fees and maintenance costs. And incompatible computers often complicated matters more than they helped.

That, combined with the slowing economy, has resulted in a meltdown in information technology buying. Once-burned and twice-shy managers are avoiding spending on technology that failed to live up to its promise. Instead, they are turning to a new breed of IT consultants who can help squeeze more out of what they've already got. Says Brent Habig, chief executive of up-and-coming supply-chain specialists Tigris Consulting: "It's a hugely appealing category of solutions for buyers who are frustrated."

It's also an increasingly attractive market for consulting companies themselves—as Habig well knows. Although small, at just \$15 million in sales, Tigris has signed 15 big-name clients looking for help wringing more performance out of aging IT systems in the past 12 months alone. Its roster now includes the likes of Procter & Gamble, Unilever Group, and Sears Roebuck. With global consulting revenues up just 3% or less in each of the last two years—down from a record 27% annual growth in 1998—many see this market as a small beacon of hope in an otherwise dismal climate. Consulting experts Kennedy Information Inc. estimates that such services are now growing at 6% to 8% a year, and will bring in about \$6 billion in revenues in 2002.

Unlike the 1990s' craze of spending millions for new gear and armies of consultants who worked on extended contracts, the trend now is toward shorter, less expensive deals that



make the most use out of existing IT resources. Booz Allen Hamilton Inc. helped a large Wall Street firm save \$12 million a year in IT maintenance by combining four separate customer-relationship management systems into one. Tigris accomplished a similar feat for Kennametal Inc., a \$1.6 billion metal-cutting tool manufacturer based in Latrobe, Pa. Says Mark D. Steele, Kennametal's director of purchasing. "Why use a sledgehammer when a tack hammer will do?"

Even more appealing: Tigris agreed that it would be paid only if it succeeded. Such contingency-fee arrangements are becoming increasingly popular with some firms. Among them: the A.T. Kearney unit of Electronic Data Systems Corp., which has 83 such deals in the works. In today's climate, says A.T. Kearney CEO Dietmar Ostermann, a consultant willing to "put your money where your mouth is" has a better chance of winning business.

With consulting work scarce, rejiggering IT systems to boost performance is likely to remain a permanent feature of the consulting landscape. Says Michael E. Weissel, vice-president of Mercer Management Consulting: "Virtually every company has some system [about which] they think, 'we could have spent that money better.'" For consultants schooled in turning such regrets into revenues, there's no time like the present.

By Louis Lavelle in New York

A new breed of consultants wrings more out of old IT systems

TECHNOLOGY

COMPUTING POWER SOLD LIKE ELECTRICITY

Palmisano throws IBM's might behind a business for the future

Samuel J. Palmisano has seen the future of computing. On Oct. 30, at New York's American Museum of Natural History, IBM's CEO unveiled what his company deems The Next Big Thing: e-business on demand. Palmisano calls it the most important initiative IBM has undertaken since the Internet hit the scene. He's throwing all the might of IBM's 350,000 employees and \$5 billion research and development war chest into the effort. "We have rallied the entire technology community at IBM around this," he says.

It's a call to arms much like the one delivered by Microsoft Chairman William H. Gates III when he wrote the legendary 1995 "Tidal Wave" memo that galvanized the software giant to move beyond PC computing and on to the Internet. Palmisano is hoping IBM's "e-business on demand" will have just as profound an impact on the way corporations buy and use technology.

Palmisano's vision is a grand one. He sees a world where companies will no longer need to worry about technology. Computing power will be dished out just as a utility supplies water to customers who pay only for what they con-

sume. Software will connect as easily as Lego blocks, and digital elves will spot potential problems and fix them before they happen. "This is exactly what customers want," Palmisano told *BusinessWeek*. "It's going to drive phenomenal productivity."

Behind Palmisano's new strategy are five key initiatives. He's banking on work already under way at IBM to push open standards such as the free Linux operating system and to push Web services. He's marketing so-called grid software for sharing computer resources. His troops are trying to convert customers to a pay-as-you-go utility model where IBM turns on the processing power and customers are billed based on how much they use. And in the research labs, an effort is under way to develop software that

PALMISANO:
*It's "e-business
on demand"*

automatically fixes bugs. Indeed, the first seeds of IBM's labor are coming to fruition. In an April upgrade of its network management software, IBM engineers built a feature that automatically predicts when a computer will run out of memory.

Sound like pipe dream? IBM wants to prove it isn't by "eating its own food." Palmisano says it will take five to seven years to transform IBM's into computers into systems that can be tapped when needed. The savings, he says, will be huge. "This initiative is worth a 5% productivity improvement each year for the next 5 to 10 years. That could translate into \$2 billion

a billion a year for IBM.

Palmisano may be betting at the right moment. With IBM doing relatively well—profits from cu-

operations were flat last quarter, a billion—it's a good time to press its advantage. What's more, corporate leaders are looking for a way to save money and get away from the headache of managing complex computer systems. "The time is right to lay out an aggressive road map," says John A. McKelvey, Merrill Lynch & Co.'s chief technology officer. That's why IBM plans to spend up to \$800 million in the next year on a campaign to convince customers of the value of on-demand computing.

But for all the hoopla, don't expect that to happen overnight—or even much of a difference to IBM's top line in the near term. Many of the products, services, and industry standards that would make on-demand computing viable are still on the drawing boards.

"We're at least five years away before the technology starts going mainstream," says IDC analyst

Melanie Posey. Even if IBM did have the goods, people are pinching corporate budgets and are wary of lofty promises.

Just ask Bob Egan, a president at Boise Cascade Corp., the \$7 billion papermaker. As an IBM customer that processes \$4.5 billion worth of e-commerce transactions every year, Boise should be an ideal customer. But Egan isn't buying into Palmisano's vision. "I can't imagine...they will be slow to install a system that is cheaper and more efficient," he says.

Palmisano may have IBM on the right track with on-demand computing. But a big payoff isn't a sure thing.

*By Spencer E.
in New*

Big Challenges

IBM is pushing the concept of on-demand computing, where tech suppliers act much like utilities and dish out processing power to paying customers. Here are the hurdles:

- Customers want productivity-boosting solutions, but they may not be eager to put all their computer needs in the hands of one company.
- While IBM is automating some tasks already, many of the technologies required for on-demand computing are years from fruition.
- Persuading customers and rivals to move to open standards is key. Otherwise, getting diverse tech products to work in sync won't happen.





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AUTOS

BOXED-IN ON THE CAR LOT

A glut of off-lease and used vehicles is driving down prices

In the late 1990s, auto makers, their finance companies, and banks pumped up vehicle sales with great deals on leases. In the past year, the industry kept sales roaring with 0% financing deals. Both schemes helped move plenty of metal, but they also have caused a flood of trade-ins and off-lease cars to dealers' lots this year. The influx of cars—combined with a soft economy—has sent used-car prices tumbling 4% this year, to below the average for 2000.

That's bad news for carmakers, for several reasons. First, the industry will be stuck with 3.3 million cars coming off lease this year, many of which the carmakers and finance companies will have to sell at a loss. Second, manufacturers have to stick with profit-eating 0% financing and rebates to keep buyers from snapping up the good deals on used cars. Finally, the losses on reselling cars have forced the Big Three to pull back on leasing. That means some would-be lessees are now buying and probably won't be in the market for a new car again soon. "There will be a giveback," says Bank One Corp. economist Diane Swonk. "The U.S. car market will be downsizing."

Already, falling used-car prices appear to be playing a major role in the softening of the new-vehicle market. Since August, sales of new cars have fallen from an annualized rate of 18.7 million to an estimated 16 million in October. One big reason: Buyers are being offered less for their trade-ins, so some have postponed buying a new car. With 91 days' worth of used cars on dealer lots, vs. a more desirable 70, dealers are accepting fewer used cars.

It's becoming a vicious circle for auto makers. If they lowball a trade-in, they must lower the price of a new car or risk losing the customer. "That's why everyone is offering cash and 0% financing," says William J. Lovejoy, General Motors Corp.'s group vice-president for sales, service, and marketing, "to make consumers feel better about the [low] trade-ins."

Making matters worse, carmakers are having a hard time getting rid of the millions of formerly leased vehicles pouring back into dealers' lots. Auto makers count on reselling these cars at a decent price and factor into their accounting what the car will be worth when the lease ends—its so-called residual value. But in an effort to lease more vehicles two or three years ago, companies pumped up the assumed residual value so the lessee would have to finance a smaller share.

Now, the bill for such games is starting to come due. Because auto makers can't find buyers, they are being forced to auction off the vehicles for less than expected. As a result, says Art Spinella,

president of CNW Marketing/Research Inc. in Bandon, Ore., an auto industry consulting firm, auto makers are losing an average of \$2,400 on every off-vehicle that they sell. The money comes straight out of auto makers' marketing budgets and the reserves of the finance companies.

The problems have carmakers scrambling to limit the damage. More and more, the auto companies are sending their used cars in for a 100-point inspection; those that pass get a certification of reliability which can bring a higher price, says Jeremy P. Aronson, president of Edmunds.com Inc., a consumer Web site that tracks car prices. GM has also set up an online auction that matches off-lease cars with used-car shoppers. Still, "two years ago, I was making money on every one of these cars," Lovejoy. "Now, I'm losing money on a lot of them."

Sputtering Detroit is having to stick with 0% financing to move new cars

What happens if used-car prices keep falling, as analysts expect, that could hurt new car sales. Further complicating things, Detroit's pullback on leasing means that only 20% of new car buyers are leasing these days, down

30% in the late 1990s. This means two to three years from now, roughly 1.6 million fewer buyers with expiring leases will need to buy new cars. Instead, the auto makers have to sell their own cars purchased with dirt-cheap financing rates. The inevitable result, says Bank One's Swonk: "Auto makers have to pull out new incentives." Not to mention the lower profits that generally come with such deals.

By David Welch in Detroit

PSST. WANNA BUY A USED CAR?

AVERAGE USED-CAR PRICE

1998 \$10,238

1999 \$11,671

2000 \$12,135

2001 \$12,237

2002 \$11,850



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A STAR ALLIANCE MEMBER 

COMMENTARY

By Julie Forster

GM FOODS: WHY FIGHT LABELING?

Should consumers have a right to know whether their foods contain genetically modified ingredients? Donna Harris thinks so. The Portland mother of two is the driving force behind an Oregon ballot initiative that, if passed on Nov. 5, would require food companies to clearly label any product sold or produced in the state that contains GM ingredients. "It wasn't the fact that these foods were on the market, but that they were on the market without consumers' knowledge," Harris asserts. "That makes people mad."

If the Oregon initiative passes, it could provide ammunition to proponents aiming for similar measures in other states. Already, efforts are underway to get the issue on the 2004 ballot in California, a state that's often the bellwether for the rest of the nation. Labeling proponents in Colorado, Vermont, and Washington are closely watching the Oregon vote as well.

Hoping to get ahead of what it fears could become a national trend, the food and biotech industries are rolling out the heavy artillery to stop Oregon's Measure 27. Worried that such labeling could cause consumers to reject genetically modified food, a coalition of farmers, biotech companies, and foodmakers has spent \$5.2 million since July in a lobbying effort to defeat the initiative.

That's shortsighted. The food industry would be better off educating the public about the safety and benefits of genetic modification. Their fear of a labeling law only means they have done a lousy job so far.

The use of genetically modified ingredients in U.S. packaged food hasn't yet

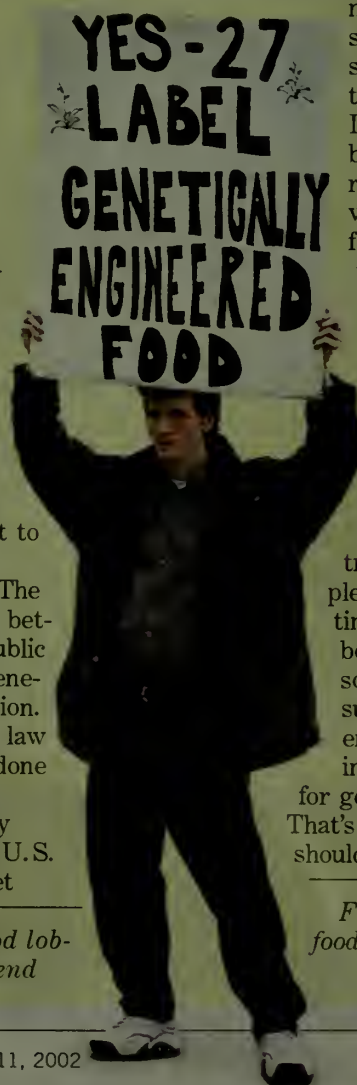
caused a consumer backlash. Many Americans don't know or don't care that, according to the Grocery Manufacturers of America, 70% of packaged-food products in the U.S. contain genetically modified ingredients. While critics complain that insufficient testing has been conducted, both the Food & Drug Administration and the World Health Organization say there is no evidence that such food is unsafe.

So why are these industries spending millions to control the outcome of an issue that isn't even top-of-mind for much of America? The food and biotech companies say they're against labeling because it would cost too much to carry out in one state. Their real reason appears to be the fear that calling attention to the widespread presence of genetically modified food will cause U.S. consumers to wonder if such food is safe. The label

"would misleadingly appear to be meant as a warning," says Pat McCormick, spokesperson for Coalition Against the Costly Labeling Law. Perhaps, but by blocking grassroots attempts to put advisory labels on food, the food and biotech industries look as if they have something to hide.

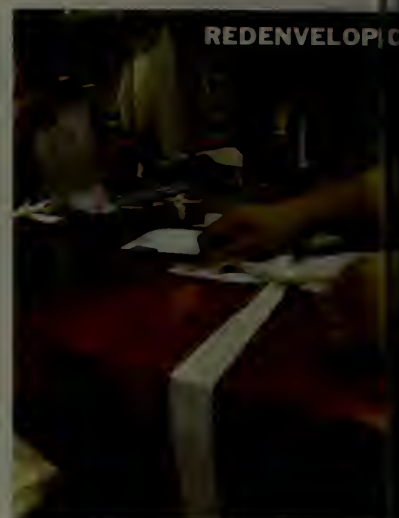
Instead, their money would be better spent educating Americans on the benefits of genetically modified food. In coming years, scientists will be able to tweak crops to add nutritional value. One example: cooking oil with 10 times as much immunity-boosting Vitamin E. Sure, some people will avoid such foods. But many, given the means to make an informed decision, will opt for genetically modified eats. That's what food companies should focus on.

Forster writes about the food industry from Chicago.



OREGON VOTE: The food lobby fears a national trend

REDEVELOPMENT



RETAILING

HAPPY HOLIDAYS—FOR E-TAILERS AT LEAST

This year's take should top last year's solid results

Is Alison May worried about plummeting consumer confidence? Hardly. Years of living on the edge of e-commerce bust, the CEO of San Francisco-based RedEnvelope Inc., an online shopping site, expects revenues to rise 50% this Christmas, to around \$100 million. That would catapult the private company into the black for the first time—and she insists it's no fluke. The Internet is so ingrained in our lives, May says. "For more and more people, it's the first place they think to shop."

As traditional retailers brace for what could be the worst holiday season in years, e-tailers face a much brighter outlook. Following last year's solid results, e-tail sales should perform again this holiday season. Forrester search estimates that after a decline in the third quarter, online sales will register a 15% annual growth rate in the fourth quarter. That works out to about \$20 billion, including \$9.5 billion in sales between Thanksgiving and Christmas. Compare that with brick-and-mortar sales, which are expected to rise only 4%, to \$209 billion, according to the National Retail Federation.

True, at just 6% of total retail e-shopping remains a small factor in the overall industry. And its current growth rates seem small compared with doubling and tripling of sales that have occurred from the industry's min-



How outsourcing is helping BP
reshape the concept of convenience stores.

Having added in quick succession the retail networks of Amoco and Arco, BP faced an enormous challenge: to rapidly unify thousands of U.S. convenience stores under a common business model, while simultaneously upgrading store locations to provide a vastly improved and enriched customer experience.

After supporting BP in the strategy and redesign, Accenture assumed centralized responsibility for retail finance and accounting services in the U.S. In this way, BP gained the freedom to

engineer bold growth, certain their initiatives would be supported by solid processes and controlled, predictable costs. For more examples of the ways Accenture can apply outsourcing to help realize your strategic goals, visit accenture.com/outsourcing

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base in the 1990s. Still, many e-tailers—both stand-alone sites and the online offshoots of traditional retailers—are showing surprising strength in an otherwise gloomy retail climate. After a strong third quarter, on Oct. 24, bellwether Amazon.com Inc. hiked fourth-quarter revenue estimates to as much as \$1.43 billion, a 28% jump over last year. Fourth-quarter revenues at eBay Inc. are expected to rise 66%, to \$365.5 million. And online sales at Lands' End Inc. are on track to hit about \$174 million, a 45% growth rate. Says Carl E. Steidtmann, chief economist at Deloitte Research: "It's all about convenience."

Indeed, a key factor driving growth is a far broader selection of products, be it the availability of custom-fit khakis or

'TIS THE SEASON TO BUY ONLINE

E-shopping could rise some 15% in the fourth quarter, to \$20 billion. Here's why:

BETTER SELECTION Consumers have more choice. Amazon expects to sell 400 brands of apparel, including Gap and Lands' End.

PROMOTIONS Price-cutting and free shipping are luring shoppers to such sites as Buy.com and Bestbuy.com.

CONVENIENCE Search engines and photos make it easier to comparison shop. Camera store Ritz Interactive offers comparisons for its five best-selling categories.

\$1,000 necklaces. Amazon is working with a group of big apparel merchants, including Gap and Lands' End, to create a new clothing area on Amazon for its 30 million monthly visitors. At the same time, better targeted and more cost-efficient promotions, such as free shipping on light or big orders, are helping drive sales without quashing profits.

Technology is also playing a role. Powerful search engines and better graphics, combined with the increasing use of fast broadband connections, now make armchair comparison shopping a breeze. Camera seller Ritz Interactive Inc. offers easy comparisons for its top-five-selling categories, including digital and video cameras.

Improved technology has also helped speed transaction time. At outdoor apparel and gear retailer Recreational Equipment Inc., sales are up 20% so far this year, thanks in part to a better search engine that zaps product info almost instantly. Just one more reason that even if retail sales stall out, e-tailers such as RedEnvelope's Alison May are feeling pretty jolly right now.

By Heather Green in New York

ENTERTAINMENT

NOW PLAYING AT IMAX: HIT MOVIES

Will rereleasing them help the company boost earnings?

After more than 30 years of eliciting oohs and ahs from screaming schoolchildren watching sharks, mountain climbers, and astronauts looming on five-story-high theater screens, Imax Corp. faces a crucial test on Nov. 1. That's when the wildly popular *Star Wars: Episode II, Attack of the Clones* will debut in Imax format on 58 screens in the U.S. and Canada, just six months after its 35mm release. The response of *Star Wars* fans will go a long way toward determining whether Imax can pull itself out of a financial funk that has hurt revenues and earnings and wiped out 85% of its stock value since mid-2000. "This could really unlock a large market for us," says Richard L. Gelfond, Imax co-CEO.

But will fans be willing to pay a buck or two over the price of a regular movie to see a previously released flick on a big screen? Hollywood studios and theater-chain owners—who foot the bill for building Imax screens—will be watching the *Clones* box-office returns closely. They'd like to see Imax create a new revenue stream. In fact, many are even asking if there's money to be made in releasing 35mm and Imax versions of movies simultaneously. "We're taking a wait-and-see approach" before committing any more *Star Wars* movies to Imax, says Bruce Snyder, president of domestic distribution for 20th Century-Fox Film Corp.

No one has more at stake than Imax, which makes most of its \$118 million in annual revenues leasing its projectors and technology to theaters. For years, it has suffered the classic chicken-and-egg dilemma: Theater chains have been hesitant to add more Imax screens until they know Hollywood is committed to the format, and studios are reluctant to go the Imax route until there are more

screens out there.

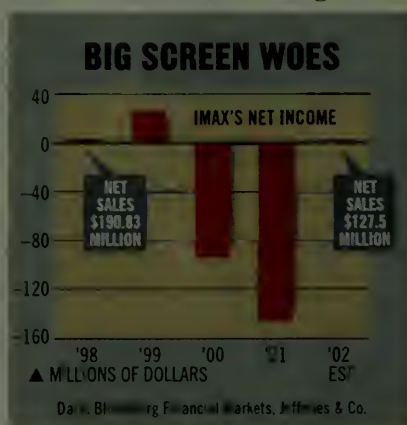
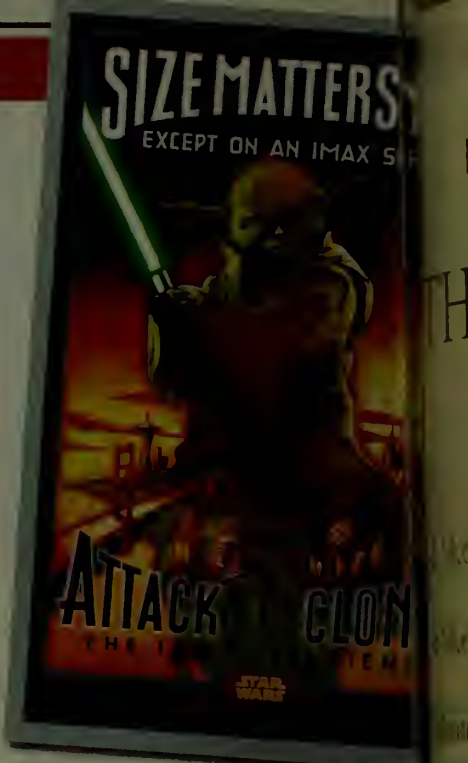
Reformatting Hollywood movies is a relatively new opportunity for Imax, which in the past several years developed a technology that allows 35mm movies to be converted to the Imax format for as little as \$4 plus \$30,000 per print. The lower spawning a lot more interest. A great way for people to see a movie, says director Ron Howard, who is to release his 1995 film *Apollo 13* in Imax in September.

Imax execs hope Hollywood's good results: Their company's sales may depend on it. Imax's sales and earnings have tanked over the past years amid a drastic consolidation of the theater industry. The Toronto-based company posted a \$145 million loss last year, largely due to one-time charges for restructurings and bad accounts.

Gelfond and Bradley J. Wechsler, co-CEO, got some good news on Oct. 30. Regal Entertainment Corp.

announced it was adding five Imax screens to its Edwards and Elmer's Artists chains, boosting its total to 10. Still, when those *Star Wars* clones hit the really big screen on Nov. 1, Gelfond and Wechsler know they truly need the format to be with them.

By Tom Low
New York



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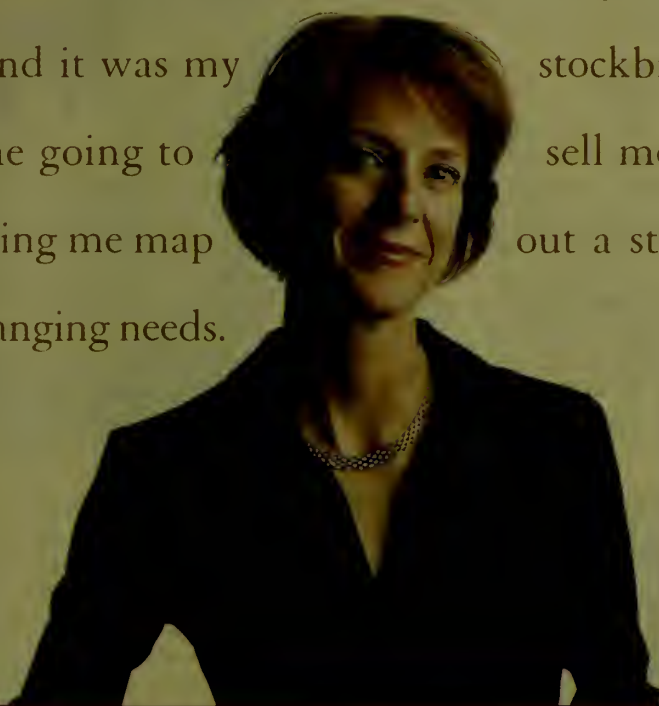
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EDITED BY ROBIN AJELLO

JEAN THERAPY AT WAL-MART

DISCOUNT-STORE HABITUÉS will soon find that nothing comes between them and their Levi's. On Oct. 30, Levi Strauss unveiled its latest offering, an inexpensive jean dubbed Levi Strauss Signature, to be sold at mass-marketers starting with Wal-Mart Stores next July. Privately held Levi's has sold its products primarily through traditional department stores, but its long-rumored move into discounters will be key to its efforts to reverse years of declining sales by drastically boosting retail distribution. In 2001, Levi's sales fell 8.3%, to \$4.3 billion.

While the Signature line will bring a cheaper Levi's product to the masses, marketing experts worry that Levi's risks eroding its already shaky brand cachet. It could also alienate its core department-store customers, who might not appreciate

seeing the Levi's name at Wal-Mart next to the laundry detergent and motor oil.

VERIZON'S STRONG SIGNAL

VERIZON COMMUNICATIONS IS a standout in the battered telecom industry. On Oct. 25, the New York-based company reported third-quarter earnings of \$4.4 billion on revenues of \$17.2 billion, beating its year-ago profit of \$1.9 billion on revenue of \$17 billion. By contrast, the other regional Bells—SBC Communications, BellSouth, and Qwest Communications—all reported revenue and earnings declines. While acquisitions helped Verizon, it was the wireless unit that provided the boost. The nation's largest wireless service posted a net gain of 803,000 subscribers for the quarter, better than No.2 Cingular Wireless.

THE SEC: NO MORE HIDING GAMES

ENRON MADE FAMOUS THE corporate tactic of hiding debt in off-balance-sheet partnerships. Now, the Securities & Exchange Commission aims to put a stop to such practices. On Oct. 30, the SEC proposed rules requiring public companies to disclose most such arrangements in their financial reports. The proposed rules would lower the threshold for disclosure, requiring companies to reveal off-balance-sheet transactions if there is more than a remote chance they'll have a material effect on the company. The SEC will issue final rules by Jan. 26.

COMCAST RIDES THE BROADBAND EXPRESS

WITH SATELLITE SERVICES signing up customers hand over fist, how can cable oper-

HEADLINER: A.G. LAFLEY

TURNING THE TIDE

When he was named CEO of then-tumbling Procter & Gamble in 2000, A.G.

Lafley vowed to build investor confidence in his turnaround one step at a time. On Oct. 29, he hit full stride: P&G posted a 33% hike in net income for its fiscal first quarter, beating Wall Street forecasts for the fifth straight quarter; even after special charges, profits were up 14%. The maker of Tide, Pampers, and Crest reported an 11% surge in sales, the biggest jump in seven years.

Even better, P&G boosted sales and profits in all five of its business sectors, de-

spite a down economy which both it and rival have stepped up price

motions. The gains show P&G is winning back customers, a key step in building a sustainable turnaround, notes Banc of America Securities analyst William Steele.

Of course, falling commodity prices and savings from restructuring gave a boost to earnings. Analysts say cutting will save P&G about \$490 million this fiscal year down from roughly \$700 million the last. Lafley's next goal: continuing to sales and profit targets those savings wind down. *Robert Be*



CLOSING BELL

THREADBARE

Tommy Hilfiger shares fell 20% to \$7.50 on Oct. 30 after the designer said profits would be lower than expected this year and sales are in a slump. Hilfiger will close 37 of its 44 stores at a cost of \$95 million. The company is seeking a new CEO to take over in 2004 when Joel Horowitz leaves.



ators keep up? Answer: with lots of new services that tap the growing demand for broadband. The strategy seems to be working: Comcast, set to become the nation's largest cable company when it closes its merger with AT&T Broadband later this year, said on Oct. 28 that it had signed up 170,000 new high-speed data customers in the third quarter. That's the most broadband subscribers Comcast has picked up in any quarter. It brings the total to about 1.3 million, or 15% of Comcast's overall cable subscriber base.

ASBESTOS FALLOUT REACHES INSURERS

THE CORPORATE ASBESTOS crisis just keeps spreading. Dozens of manufacturers who subjected workers to the toxic material in the '60s and '70s have been bankrupted by jury awards. On Oct. 25, a

jury found Union Carbide responsible for causing asbestosis injuries to workers. No insurers are suffering from asbestos exposure as yet. On Oct. 30, property-casualty insurer Chubb said it lost \$100 million in its third quarter due largely to its need to set aside \$625 million in reserves to cover claims from manufacturers it insured. Chubb isn't alone: Travelers Property Casualty and Allianz boosted their asbestos reserves earlier in October. St. Paul added to its reserves last June after settling a claim worth \$580 million.

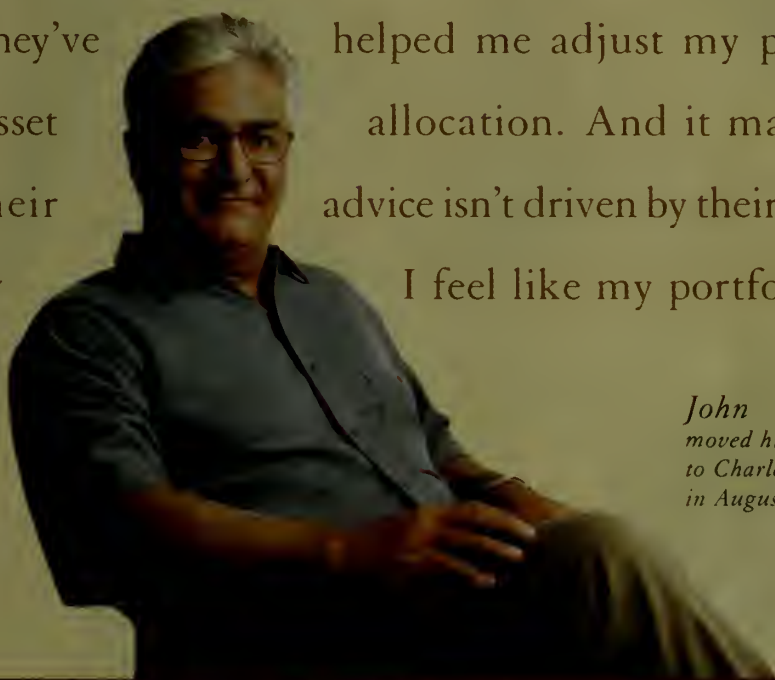
ET CETERA...

- Qwest Communication announced \$41.4 billion in write-offs and restatements.
- Warren Buffett will step down from Gillette's board in May, after 14 years of service.
- Boeing will cut up to 10,000 jobs.

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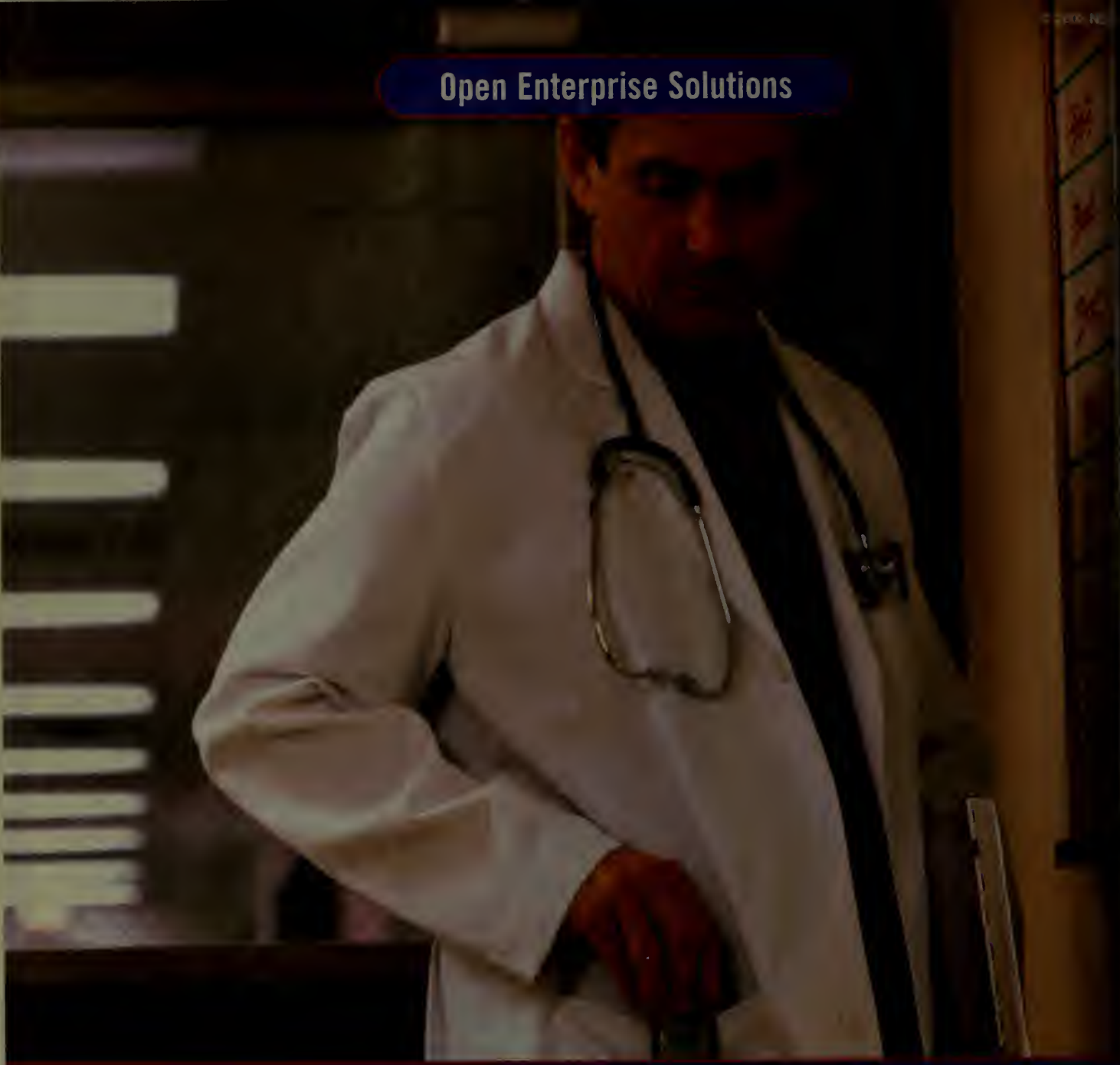
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CHARD S. DUNHAM

STALLED ECONOMY WIDENING THE GENDER GAP

As love to talk about America's red zone-blue zone split—polarized regions commanded by Republicans and Democrats, respectively. But to find the biggest partisan divide, you need look no farther than the dining-room table. As uncertainty over the economy grows, men are increasingly going to pro-growth Republicans while women find solace in Democratic appeals for a stronger social safety net. Forget the gender gap—this divide is fast becoming a gender chasm. The differences—most extreme among young and old voters—pose special problems for the growing ranks of women seeking office. Female Dems must overcome racial sexism, and GOP women must appease some female voters not to desert them because of their party. Examples abound in the battle for governor. In New Hampshire, Democratic Senate nominee Jeanne Shaheen has a 14-point lead over Republican E. Sununu, according to an American Research Group poll. But that is only by his 56%-40% edge among women. And in suburban Baltimore, Republican House candidate Helen Delich Lujan is trailing in a GOP district despite a seven-point lead among men. The reason: Women favor Democrat Robert Ruppertsberger, 49%-38%, according to a Gonzales/Arscott poll. While the overall rise in the gender gap is modest, it has widened among certain groups—such as sixtysomethings and those under 30. In both cases, men are trending Republican and women are becoming Democratic loyalists, according to the Pew Research Center for the People & the Press. And, men 60 to 69 are the most Republican of all age groups, favoring GOP candidates, 51% to 35%. Their female counterparts lean Democratic, 45% to 39%.

DINNER-TABLE STANDOFF



CATEGORY	WOMEN		MEN	
	D	R	D	R
ALL	44%	35%	35%	42%
COLLEGE GRADS	47	38	35	51
\$50K-\$75K INCOME	43	39	32	51
NON-PARENTS, AGE 18-49	65	26	35	57
AGES 25-29	46	28	26	41
SENIORS	46	38	38	46
SOUTHERNERS	45	37	33	46
HISPANIC	54	22	42	32
NON-LATINO CATHOLIC	44	37	34	47

Data: Pew Research Center for the People & the Press

The split has also grown among college-educated and Southern women: They've moved toward the Dems as their husbands remain with the GOP. "The gender gap is as much a political reality in a divided America as socioeconomic or regional differences," says Pew Director Andrew Kohut. Why the divergence? In an uncertain economy, women—particularly the elderly and young workers—are more nervous about the future. And women are more likely to reject Republican social conservatism. But where gender chasms have emerged, the common thread is "a dramatically different perception of the role of government and the need for a social safety net," says Democratic pollster Celinda Lake. While the trend has helped Dems, it's increasingly a drag on various blocs of male voters. Of particular concern: Hispanic men. President George W. Bush's relentless outreach has cut the Dems' advantage among Latino men to 10 points, Pew found, but women remain staunchly Democratic. The GOP also has a big edge among Catholic men of European descent; Catholic females lean Democratic. "Male trouble" has complicated the gubernatorial races of seven female Dems. With 45 states in budget crises, says Lake, "men are having doubts that...[women] can handle the job." Candidates who fare best have no-nonsense reps, such as Attorneys General Janet Napolitano of Arizona and Jennifer Granholm of Michigan. Once, political pros dismissed the gender gap as a one-time reaction to Ronald Reagan. No more. With the midterm elections so close, control of Congress—and the fate of a handful of female candidates—could be decided in the trenches between men and women.

CAPITAL WRAPUP

SEPTEMBER 11 FACTOR

A new special-interest group is emerging in this election: families of September 11 victims. On Oct. 30, a coalition of groups ran ads in six Georgia papers chastising GOP Representative Saxby Chambliss for blocking an independent commission to study the attacks. Chambliss is trying to unseat Democratic Senator Max Cleland.

UMBS UP FOR POWELL

Harry Belafonte's barbs aside, Secretary of State Colin Powell is the most

popular Administration figure among African Americans, says the Joint Center for Political & Economic Studies, a think tank geared to minority issues. A new survey gave Powell a 73% favorability score. National Security Adviser Condoleezza Rice got 41%.

FALSELY KNOCKING FRITZ

► As Walter Mondale replaces the late Minnesota Senator Paul Wellstone on the Dem ticket, some GOPers are gleefully reporting that the ex-VeeP supported Social Security private accounts—a largely GOP idea that doesn't

seem all that smart these days—when he co-chaired a 2001 commission on global aging. But the panel didn't back private accounts: It urged "a gradual transition to market financing of public pension systems." Mondale dissented.

DON'T CALL IT PRIVATIZATION!

► There's more evidence that Social Security privatization is a political loser. Cato Institute, longtime champion of the idea, has changed the name of its seven-year-old Project on Social Security Privatization to a less threatening Project on Social Security Choice.

ANTITRUST

TRUSTBUSTER ON TRIAL

Can the EC's Monti bounce back?

European Commissioner Mario Monti has known better days. On Oct. 25, Europe's high priest of competition and his Brussels-based Merger Task Force—a 75-strong group of lawyers and economists that reviews and occasionally disallows proposed mergers in the European Union—suffered their third reversal in less than five months from Europe's second-highest court. Worse, it was the second slap in a single gruesome week. Before then, the task force had been overruled only twice in its 12-year history.

For the legendary trustbuster who blocked General Electric Co.'s bid to buy Honeywell International and has taken on software giant Microsoft Corp., this setback is a watershed. True, nothing in the rulings by the Luxembourg-based Court of First Instance questioned Monti's authority or weakened the laws under which he operates. But the political effect was obvious: In its rapid-fire reversals, the court put the EU's competition gang on notice that their swashbuckling days are over. "It was a major blow to the institution," says Alec J. Burnside, a Brussels-based partner with British law firm Linklaters & Alliance, which does work for Microsoft.

CEOs who crossed swords with Monti undoubtedly exulted. So, probably, did European policymakers who prefer a weak Brussels to a strong one. But don't think this defeat will force Monti out. To restore his credibility, he's already rooting out the rot. The three cases were lost mostly because staff attorneys stitched together evidence into incomplete or even contradictory scenarios. Blame that in part on a workload that tripled during the final years of the economic boom. "The court said the work itself was sloppy," says attorney Jacques Bourgeois, a former antitrust adviser to the European Commission and now a partner at Akin Gump Strauss Hauer & Feld LLP in

Brussels. To fix that, Monti aims to hire a chief economist to beef up his team's analysis. He and new director general Philip Lowe will more closely supervise junior staff, who in their zeal may have pushed the legal envelope. So Monti will expand the use of so-called Devil's Advocate Panels—moot courts that vet controversial decisions before they're released. "I am determined to do my utmost to ensure [these problems] not happen again," he told reporters in Brussels at an unusual public appearance on Oct. 25.

Monti has to whip the merger group into shape before what could be an even bigger loss. The courtly Italian leapt to global renown after he stared down former GE CEO Jack Welch in 2001. Now, given the court's greater scrutiny of EU decisions—and its apparent willingness to reverse them—experts think Monti could be hit again. "It seems likely that GE/Honeywell will be overturned because it relies on the same legal logic," says Ernest Gellhorn, an antitrust specialist and professor at George Mason University School of Law in Arlington, Va. Any such decision would come far too late to resurrect a deal with Honeywell, but GE is pursuing the case as a matter of principle.

The possibility of a reversal in the GE case will be hanging over Monti's office as he pursues his landmark antitrust case against Microsoft. The EU alleges the software giant abused its market power in Europe by using dominance in desktop operating systems to move into media software and operating systems for computer servers. A preliminary decision on the charges is now expected before the end of the year, most likely after U.S. District Judge Colleen Kollar-Kotelly rules on the remnants of Microsoft's U.S. antitrust case. The judge is examining the settlement made between Microsoft and the U.S. Justice Dept. and

deciding whether to accept altered remedies sought by nine states balked at the deal.

Some legal experts now question whether a chastened Monti will have the gumption to go forward with a European case if Kollar-Kotelly sides with Washington. "If she accepts the Microsoft settlement, it will be awfully hard for him to press forward," says an ex-Justice official who worked on



MONTI'S MESS

WHAT HAPPENED

STRIKEOUT On Oct. 25, a top European court reversed a ruling by the EU's competition commissioner blocking a merger between two food-packaging companies. It was the second reversal in one week, and the third in less than five months.

BLACK EYE The court didn't question Monti's authority or legal theory. But it sharply rebuked his analysis, conclusions, and procedures.

HOW MONTI IS RESPONDING

HIRED HELP The competition unit will hire a chief economist to improve its market analysis, and top antitrust lawyers will closely supervise junior staff.

TESTING THE WATERS Monti will enlist a "devil's advocate panel" to preview controversial cases before the verdicts are announced. It's not quite the judicial model used in the U.S., but it's a nod in that direction.

IMPACT ON MICROSOFT

RAISING THE BAR

Monti and crew will have to make sure their case against Microsoft is solid—or bail out. Experts note the reversals didn't reject legal principles critical to the Microsoft case.

APPLES AND ORANGES

The overturned cases were all mergers, but Microsoft is up on charges of anticompetitive behavior. With ample documentation of abuse and a loss already notched in U.S. court, the software giant can't rest easy.

states against Microsoft. If Microsoft doesn't like Monti's decision, it can appeal to the same Luxembourg court that has caused him such grief. Still, European law makes sticking monopoly charges easier. "It's more interventionist than the U.S.," says Professor Eleanor M. Fox, an antitrust expert at New York University School of Law. For instance, the theory of leveraging—that a monopoly is guilty of abuse if it uses its power in one market to horn in on another business—has been largely discredited in the U.S. but is still recognized in Europe.

To avoid running afoul of the court, Monti and crew need to scrupulously avoid procedural errors. Judges overturned the EU's ban of a merger between two French electrical equipment makers partly because the Commission didn't give plaintiffs adequate opportunity to respond or propose remedies. Microsoft won't say how much access it has to Monti, but it has complained privately that its efforts to forge a settlement have been rebuffed. Blame that in part on the commissioner's aversion to back-room deals—a tendency that will surely be heightened by the unwelcome new scrutiny he is receiving.

The wild card is the Luxembourg Court of

First Instance. If Microsoft is celebrating the rise of a new counterweight to Monti, it's not letting on. A more aggressive judiciary, providing greater checks and balances on the EU's administrators, could go some ways toward closing the gap between the U.S. and European antitrust systems. But if Monti throws the book at Microsoft, all bets are off.

By Andy Reinhardt in Paris, with Dan Carney in Washington



Assuming he does, Monti has the authority to impose fines of up to \$2.5 billion against Microsoft.

Most experts think Monti's setbacks make him more determined than ever to make his mark. "I don't expect the commission to lower its enforcement of antitrust law just because it has lost a few cases," says Frédéric Louis, a partner in the Brussels office of law firm Wilmer, Cutler & Pickering. For one thing, Mi-

crosoft is being pursued by the antitrust division, which operates under different statutes.

Of course Monti will be working in a tougher legal climate, now that the Luxembourg court has bared its teeth. "The commission will have to be extra careful to make sure it has proved its case and that the economic argument is sound," says Stephen D. Houck, a New York attorney who led the case by 19 U.S.

COMMENTARY

By Paul Starobin

CHECHNYA: TIME FOR THE WEST TO PRESSURE PUTIN

A hard line. That's what Russian President Vladimir V. Putin took to resolve the Moscow hostage-taking crisis that gripped his country last week—and that's what he is sticking to in his approach to the underlying cause of the ordeal in the first place, the bloody, stalemated war in the breakaway Russian republic of Chechnya. It's a formula with little prospect for success—and it's in the interest of Western leaders to help him to see that.

Putin's decision to send in Russian special forces to free some 800 captives in a Moscow theater from Chechen terrorists armed with explosives was a difficult but defensible call. At least 117 people have died from the fentanyl-based gas used to immobilize the hostage-takers—but who's to say the terrorists would not have killed everyone in the building? "We showed that Russia cannot be brought to her knees," Putin said on Oct. 26.

But the price of preserving the motherland's honor—if Putin, as he is signaling, refuses even the idea of a negotiated settlement to the Chechen conflict—is likely to grow in the days, months, and, yes, years ahead. His tactics are no more likely to subdue the Chechens than the get-tough policies of Israeli Prime Minister Ariel Sharon have vanquished the Palestinians, also fighting a war of self-determination.

After all, some 4,500 Russian soldiers have already died in three years of savage fighting—and another 10,000 died in the first Chechen war from 1994-96. Putin's claim that Russian forces control the ground in Chechnya is belied by continuing rebel assaults on Russian units and helicopters. "Using only military force, we will never have a solution,"

says Grigory Yavlinsky, leader of Russia's liberal Yabloko party.

The Moscow hostage-taking brought the war home to a political elite that has attempted to deal with Chechnya as a nettlesome but manageable problem. The public has been shielded from the war's brutality by Putin-muzzled broadcast media. Now, with illusions of quiescence

terests. For now, less of his time go to essential overhauls of the electricity, gas, banking, legal, and education sectors. Granted, the new focus on anti-terrorism efforts may in the short term ease the market's concerns about Russia's political stability. But the pace of important structural reforms could slow, which over the long haul will turn off foreign investors.

Putin says he's fighting international terrorism—alongside the U.S. in its battle against al Qaeda. There are undoubtedly links between Chechen insurgents and Arab Islamic militant groups, who have helped to finance and train the rebels. But the origin of the Chechen conflict lies not in Islamic militancy but in the 19th-century Chechen struggle to resist absorption by the Russian empire. Osama bin Laden's group, with its broad focus on America as a global evil, has amorphous aims. The Chechens have a specific objective: independence. Such a focus opens the door to diplomacy.



HOSTAGE MEMORIAL Russia's refusal to negotiate with the Chechens came at a high price. It will go higher still

shattered and terrorism brought directly to the capital, Putin must pay urgent attention to the grim and perhaps unattainable project of constructing a Fortress Russia. Chechen rebels are threatening to strike at economic targets, including nuclear power stations. With the largest land mass of any country in the world, Russia is a wide-open target for such assaults.

As security services ramp up their anti-terrorism operations, Putin's principal domestic priority, the rebuilding of the nation's economy, inevitably stands to suffer. Although Putin has given broad direction to his economic team to pursue a liberal policy course, he frequently is called upon to settle disputes on key initiatives between warring business in-

Indeed, former Russian Prime Minister Yevgeny Primakov, says the Kremlin must talk to local Chechen rebel commanders to find a political solution. That's unlikely, unless the international community nudges Putin towards pursuing a negotiated settlement. U.S. President George W. Bush has given Putin a free hand in Chechnya. But this is no great favor to Russia, in whose social and economic health the West has a stake, too. "We're all hostages to a flawed policy," says Lyubov Kuznetsova, 49, a founding member of the Soldiers' Mothers Committee of Russia, an antiwar civic group founded in 1989. She's right. Now, more than ever, is the time to search for a way out.

With Catherine Bell



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INSURANCE

HOW AFLAC LAID A GOLDEN EGG IN JAPAN

Can the insurer keep racking up huge profits?

It's a case of the tail wagging the dog, or, in this case, the duck. AFLAC Inc., a Columbus (Ga.) supplemental health insurer, raised its brand recognition enormously in the U.S. with TV commercials featuring a duck that incessantly quacks "Aaaa-flaaaak." AFLAC isn't using the duck right now in its Japanese ads, but no matter: The company's business in Japan dwarfs its home market, accounting for 70% of AFLAC's operating earnings and 80% of its \$38 billion in assets.

Indeed, American Family Life Assurance Co., or AFLAC, is the largest foreign insurer in Japan and second-most-profitable *gaijin* company, after IBM. Merrill Lynch expects pretax Japanese profits to reach \$940 million this year, up 14% from last year. Japanese revenues are expected to rise 5%, to \$7.6 billion. "Japan is our driving force," says AFLAC Chief Executive Daniel P. Amos.

How did AFLAC, founded by the Amos family in 1955, ever manage to crack Japan's notoriously cordoned-off financial-services industry? Back in 1970, Amos' uncle, John, then the CEO, made his first trip to Japan and marveled at how Japanese wore cotton surgical masks to ward off colds and other bugs in crowded trains and urban areas. Clearly, Japan was the kind of big, health-obsessed consumer market where AFLAC could thrive. Moreover, AFLAC's best-selling product, which reimburses out-of-pocket expenses for cancer treatments, is well suited to Japan, whose state-run health system doesn't cover such treatments generously. In 1974, the Ministry of Finance handed AFLAC

with well-known, trusted names been successful, says HSBC Securities (Japan) Ltd. analyst Rie Ota. In fact, foreign insurers and several local ones have closed up shop since 1991, including U.S.-based Allstate Insurance. "New entrants have found it difficult to establish a brand name," says AFLAC, on the other hand, has a well-established brand, enhanced last

when dubbed *ver* of its duck commercials ran on TV. Now, AFLAC is developing a new blitz for 2004 that will feature the duck and Japanese actors.

AFLAC needs to keep up the brand-building because local competitors now have the company in their sights. Last year, the Japanese government allowed property and life insurers such as Tokyo Marine & Fire Insurance Co. and Nippon Life Insurance Co. to move into specialty-insurance markets.

Investors, fearing the company would be crushed, pushed AFLAC's stock price down. Amos went on the offensive, clinching a distribution deal with Dai-ichi Mutual Insurance Co. to contribute its cancer policies. AFLAC has also begun offering stand-alone medical benefits, last year it rolled out Japan's first accident insurance policy. In late-2000 all-time high.

In any case, AFLAC's competitors are hard-pressed to match its efficiency. AFLAC doesn't rely on a legion of expensive sales agents, and it processes claims online. So its cost to acquire a new policy is about \$72 to \$120 for Japanese rivals. Amos and his crew have also done a far better job of investing the roughly \$30 billion in assets AFLAC controls in Japan—by buying local stocks and real estate. AFLAC earns annual returns of 4%, two percentage points better than the average Japanese insurer. This is one company with plenty to quack about.

By Brian Brenneke
in Tokyo



AMOS SAYS JAPAN IS "OUR DRIVING FORCE"

GETTING THEIR DUCKS IN A ROW

▶ AFLAC Japan provides supplementary insurance for cancer treatment or other insurance-covered expenses to one out of every four Japanese

▶ With 1996 earnings expected to grow 10%, AFLAC has the highest growth rate of any foreign company in Japan

▶ AFLAC Japan owns 70% of the Dai-ichi Mutual Insurance Co. and has a 10% stake in the company's Japanese subsidiary

one of the rare licenses awarded to foreign firms, in part because Japanese insurance giants didn't see much of a market in such a niche business.

Big mistake. Today, AFLAC covers one in four Japanese with its policies; some 95% of all listed Japanese companies offer its products through payroll-deduction plans. Factor in Japan's rapidly aging population, and the expected increase in premiums and decrease in coverage under the national health plan, and AFLAC's prospects in Japan seem boundless, even with the currency-exchange worries that come with doing so much business in a foreign country.

Haven't other foreign insurers figured that out, too? Sure, but only those



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CHINA: IT LOOKS LIKE JIANG WILL RULE FROM THE WINGS

ould he go, or not? For months, China watchers have been speculating about whether Chinese President Jiang Zemin, 76, would oversee a long-awaited orderly transfer of power in Beijing—or make a last bold bid to remain in charge at the 16th Communist Party Congress beginning on Nov. 8. Now, signs are strong that Jiang is indeed preparing to make way for a new leader—59-year-old Vice President Hu Jintao—by stepping down from his party post and from the presidency early next year.

Jiang has no intention of fading from the scene. Once derided as a marginal and transitory figure, he has skillfully made sure that he exerts major influence over China's foreign and economic policies, perhaps for years to come.

At least three of Jiang's protégés will be promoted to key posts by the Communist Party, putting them in a position to advance his agenda. Above all, Jiang aims to remain a powerful presence as a party elder after his retirement, much as paramount leader Deng Xiaoping did until his death in 1997. Jiang is so confident of his stature that he may even give up his post, analysts had long expected he would retain the chairmanship of the Central Military Commission. (Deng held that job for two years before retiring from other party posts.) "Jiang wants to appear more modern than Mao or Zhou," says an editor with a Beijing political journal. "Giving up all his positions makes him appear a man in China's history."

If Jiang does quit them, his key supporters in the all-powerful, seven-member Politburo Standing Committee will play a vital role in maintaining his influence. On Oct. 22, the media announced that Shanghai Party Secretary Huang Jinchao, 64, and Beijing Party Secretary Jia Qinglin, 62, would take jobs in the central government. At least one of them—probably Huang—is expected to be promoted to the

Standing Committee. Meanwhile, on Oct. 24, 63-year-old Zeng Qinghong stepped down from his job as head of the party's Organization Dept. This is also seen as a signal that he soon will join the top echelon of leadership, analysts say.

Zeng, Huang, and Jia have all worked closely with Jiang. Zeng, the only official from Shanghai whom Jiang brought with him to Beijing in 1989, is the President's closest aide. Jiang chose Jia to take over as Beijing's mayor in 1996 after his predecessor was arrested on corruption charges. Jia may

be beholden to Jiang because of rumors that Jia's wife was involved in a smuggling scandal. A corruption crackdown has netted officials with ties to top leaders such as Li Peng, but no one close to Jiang has been implicated.

On the policy front, Jiang's continued influence is likely to spell a stable transition. Leaders in Beijing broadly agree that China must continue its economic opening. Hu, known as a consensus builder, is unlikely to challenge Jiang openly. "Hu will try to make this as seamless a transition as he can," says Kenneth Lieberthal, a China expert at the University of Michigan. Hu can be expected to heed Jiang's advice on foreign policy, an area where he has little experience. Jiang, who recently enjoyed a visit to President George W. Bush's Texas ranch, is likely to keep pushing for better ties with the U.S. and a softer line on Taiwan.

Of course, any transition of power can turn up surprises. And no one really knows how the new crowd of sixtysomethings will interact with each other—and with Jiang—until they assume their new posts. For example, one longtime rival, Li Ruihuan, 68, may try to limit Jiang's protégés' influence if he keeps his position on the Standing Committee. But for now, Jiang—China's aspiring new paramount leader—seems to have stacked the deck strongly in his own favor.

By Dexter Roberts in Beijing



JIANG: Protégés in place

GLOBAL WRAPUP

POLITICAL CRISIS IN ISRAEL

Israeli politicians are gearing up for a new election season, now that the Labor Party has abandoned its coalition with Prime Minister Ariel Sharon's Likud Party. Labor Defense Minister Benjamin Ben-Eliezer and Foreign Minister Shimon Peres were ousted from the Cabinet on Oct. 30 in a dispute over Israel's 2003 budget. Sharon will now scramble to form a new coalition with the ultra-right National Union. But that coalition would have a majority of only a few

seats in Israel's Knesset and could face a vote of no confidence as soon as Nov. 4. That's why analysts expect Sharon will have to call a new election, which could take place early next year. The vote is currently scheduled to be held in November, 2003.

Both Labor and Likud must vote on their party leaderships before they can contest a national election. Labor Party leader Ben-Eliezer is facing a challenge from Amram Mitzna, the popular Mayor of Haifa and a former general, as well as from Haim Ramon, a maverick Knesset member and former

minister in previous Labor-led governments. Ben-Eliezer is trailing behind his rivals in the race, which will be decided on Nov. 17. Meanwhile, in the Likud Party, former Prime Minister Benjamin Netanyahu has a credible chance of winning his leadership contest with Sharon, analysts say. Although Israeli voters are exhausted from two years of violence with the Palestinians and the country's worst-ever recession, recent polls show the electorate would likely return a Likud-led government to power.

By Neal Sandler in Jerusalem

COMPUTING

IS THE PEN FINALLY MIGHTIER THAN THE KEYBOARD?

Microsoft says it has tablet PC software that works. Here's the inside story

For years, William H. Gates III and Warren E. Buffett have routinely mailed each other magazine articles that have caught their eye. They rip pieces out of the magazines, jot notes in the margins, and pop them in the mail. Gates anticipates the day when he won't have to mess with all that. With his new Tablet PC, he plans to call up articles from the Web, scrawl thoughts

on the screen with a digital pen, and shoot it off to Buffett via e-mail. He's already using an early version of tablet software to send electronically annotated articles to Microsoft colleagues. "I have anticipated this for many, many years. And here it is," says Gates.

Few technical quests have consumed Gates as much as the notion of replacing pen and paper with an electronic tablet and stylus. When he brainstormed with Microsoft co-founder Paul Allen in the 1970s about what PCs would eventually do, he dreamed of machines that would process handwritten notes. He pushed Microsoft Corp. into the business a decade ago, when several computer makers, including Apple Computer Inc.

with its Newton, made a run at pen-based computing. When that failed, Gates kept at it, funding research and waiting for the time when the electronic pen could become mightier than its inky ancestor.

Gates believes that time is now. Microsoft and its hardware partners have resolved many of the problems that dogged pen computing in the 1990s—poor screen resolution, short battery life, and woefully inaccurate software for deciphering handwriting. On Nov. 7, the company will launch a new version of its Windows PC operating system for the Tablet PC. Seven computer makers are offering this new breed of PC with screens that double as electronic notepads. Some look just like a laptop—except that the screen s

BELIEVER:
The tablet has been a personal quest for Bill Gates



degrees and folds down over the board to convert to a writing surface. Others have screens that detach from the keyboard. The gizmos will range from \$1,800 to \$2,500.

With advances in technology and Microsoft's marketing muscle, the Tablet has a good chance of catching on. It will take some time, particularly on the tech spending so tight. Forrester Research Inc. analyst Frank E. Gillett sees only a few hundred thousand Tablet PCs will be sold the first year, "because the user interface isn't as easy to navigate as it should be. But, I say: 'I'm bullish on this in the long run.'" Microsoft has spent \$400 million on the technology and plans to spend \$70 million more marketing the Tablet PC. Gates thinks at least 500,000 will be sold in the first year.

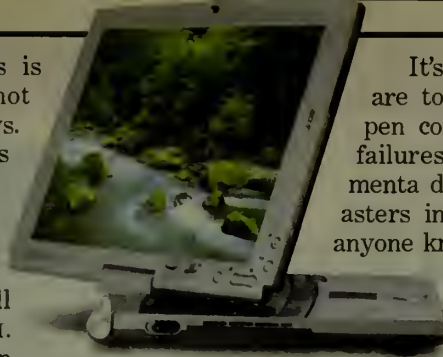
Some early users are enthusiastic. In New York law firm Weil, Gotshal & Panges LLP handed out tablets to 20 attorneys in its Silicon Valley office. At the time, the lawyers weren't quite sure they would do with them. Now, they won't let them up. They like being able to create electronic documents. "When we launch, we will buy only pen-based devices," says Weil Chief Information Officer James McGinnis.

Not everybody is so upbeat about Tablet PC's prospects. Jerry Kaplan, founder of pen pioneer GO Corp., dismisses Gates's new baby as science in search of customers. "There's no evi-

dent demand. This is a technology push, not a market pull," he says.

Moreover, Gates's revolution will have to start without two of the industry's most important soldiers: Dell Computer and IBM. Dell President Kevin B. Rollins says it will wait to see how the market develops before jumping in. IBM is more circumspect. "We don't see significant growth opportunities," says Fran O'Sullivan, general manager of PC products and services at IBM. If that changes, IBM will get on board.

Gates believes they'll both jump in once they see the market develop. "If a tablet is to do what I expect it to, you won't have anyone who makes portable computers who doesn't make tablets," Gates says. The tablet has become such a personal quest for Gates that his lieutenants feel added pressure to uphold his reputation. "I would be lying to you if I told you that I didn't wake up in the middle of the night in a cold sweat," says Alex Loeb, the Microsoft vice-president who leads the tablet effort.



So far, neither **IBM** nor **DELL** is making tablets. Gates is sure they'll jump in

ACER'S VERSION OF THE TABLET

It's no wonder Loeb's nights are tormented. The history of pen computing is littered with failures. Pioneers GO and Momenta defined Silicon Valley disasters in the early 1990s before anyone knew what a dot-com was.

Microsoft's stab at the business, Windows for Pen, was launched in 1992, but made little headway. And the failure of the Newton's handwriting technology was so abject that Garry Trudeau mocked it in his *Doonesbury* comic strip.

The seeds for Microsoft's second run at the tablet were planted five years ago, when

the company hired Dick Brass, who pioneered the electronic-dictionary business in the early 1980s. Microsoft wanted him to revive the pen-computing dream.

The first rough design for Microsoft's new tablet was made by a carpenter who worked on Brass's 55-foot Pilothouse Trawler. The wooden model had a flat base with a keyboard and a flat screen that could be carried separately. It cost Brass about \$2,000. Brass proudly lugged the model into Gates's office for their first face-to-face meeting after he was hired in November, 1997. His new boss told him it was the kind of machine he

THE TABLET'S LONG AND WINDING ROAD

1989 - GRiD Systems unveils GRiDPAD, the first portable computer with a touch screen. Sales don't match hype. GRiD's head architect, Jeff Hawkins, later leaves to start handheld pioneer Palm Computing.

1991 - GO Corp. debuts pen-based tablet. AT&T acquires it and shuts it down by mid-1994.

1992 - Apple unveils pocket-size Newton. Its flashy handwriting recognition becomes a plot line in *Doonesbury*. Apple drops the plug in 1997.

- Gates launches Microsoft's Windows for Pen product stalls at launch and is gone by 1995.

1996 - Palm ships handheld computer,

the Palm Pilot. It's the first pen-based computer to succeed.

NOVEMBER, 1997 - Oracle veteran Dick Brass joins Microsoft to work on tablet technology.

SPRING, 1999 - Brass gets the O.K. to pursue the tablet. He hires PC pioneers Butler Lampson and Chuck Thacker, as well as Bert Keely, an engineer who led a tablet project at Silicon Graphics. He persuades Alex Loeb, who was in the Office group, to run the tablet group.



BRASS

NOVEMBER, 2000 - Gates features the tablet in his speech at the Comdex technology trade show.

FEBRUARY-MARCH, 2001 - Microsoft sends 40 tablets to Minneapolis for a six-week field trial at three companies. Users learn a key feature that tries to predict if they're writing or navigating with their pen.

MAY, 2001 - After heated debates, Loeb pulls the technology from the tablet. Some angry developers threaten to quit the tablet team. Even Gates is disappointed.

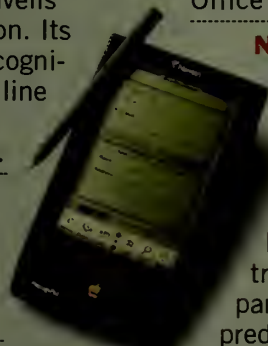
AUGUST, 2001 - Loeb worries that Gates's support for a 2002 launch is wavering. At a meeting, Gates pushes for handwriting features in Microsoft Office at the launch. That done, he greenlights the project for 2002 launch.

NOVEMBER, 2001 - First prototype tablets emerge. Acer builds a laptop with a swivel screen that flips over into a writing pad. Gates features them in his Comdex speech.

MAY, 2002 - Gates takes 150 tablets to Microsoft's annual CEO Summit. Loeb frets that the devices aren't ready, but they work.

AUGUST, 2002 - Tablet software is released to computer makers. The team parties, rocking to Keely's band.

NOVEMBER, 2002 - Tablet launches, with seven PC makers unveiling new products.



APPLE'S NEWTON

had been dreaming about for years. But Gates gave him a budget for only six engineers, not the 20 Brass sought.

So Brass began assembling a team that would make up in brainpower what it lacked in numbers. He started by focusing on Microsoft's electronic-books effort. By mid-1999, he decided it was time to create the tablet, so he plucked two of the brightest scientists from Microsoft's vaunted research lab—Chuck Thacker and Butler Lampson. The pair had worked together in the early 1970s at the legendary Xerox Palo Alto Research Center developing the Alto, the world's first personal computer. Rounding out Microsoft's original tablet team was Bert Keely, who had headed tablet development at Silicon Graphics Inc. before joining Microsoft a year earlier.

To run the new group, Brass looked down the hall. A few offices away, Loeb was working on document imaging for Microsoft's Office group. Brass saw her as a spitfire who wouldn't be intimidated by the big brains of Thacker, Lampson, and Keely, or be cowed by pen computing's checkered history. It took some persuading. Brass wooed Loeb, a Georgian, over soul food from Dixie's BBQ in nearby Bellevue, Wash. "I would start by nibbling the cornbread. By the end, my face was greasy with ribs," Loeb says.

The first big bet the group made was to use Windows as the tablet's operating system. It seems like an obvious

choice, but Windows is a power hog. That meant battery life, key to a mobile gadget such as the tablet, would be short. One crucial benefit outweighed the negatives: 10,000 applications run on Windows, so laptop users wouldn't have to give up anything by switching to a tablet.

At the same time, the team realized that they couldn't perfect handwriting recognition. Their software could accurately translate handwriting for only half of the users they tried it on. For the other 50%—forget it. So Microsoft emphasized storing handwritten notes.

Next, the tablet crew had to make a prototype to see if their ideas would work. Thacker knew that PC processors sucked up too much power. If the tablet couldn't run for more than an hour or two on its battery, users wouldn't take it to meetings or out of the office. One day in September, 1999, serendipity struck. While walking down the street in Palo Alto, Thacker bumped into Patrick Boyle, a colleague from his days



"I would be LYING TO YOU if I told you that I didn't WAKE UP in the middle of the night in a cold sweat," says tablet team chief Loeb

LOEB RODE HERD OVER BRAINIAC RESEARCHERS

at Digital Equipment Corp. Boyle, it turned out, worked for Transmeta Corp., a startup that had a chip that used 70% less power than comparable processors. With the Transmeta chip, Thacker completed his designs by December.

What emerged was a gunmetal-gray gizmo that looked a lot like an Etch A Sketch. "It was pretty amazing for people to hold it in their hands and have Windows come up on that screen and just scribble a little bit," Gates recalls. "You'd say: 'Boy, this thing looks like you could really do it.'"

The coming-out party for the machine happened about 18 months after Brass got started, in November, 2000, at Comdex, the tech industry's annual hype-fest. The team faced a mad dash to get ready for Gates's keynote. The software needed to be refined, new prototypes had to be made, and tablet marketing needed to take shape. "I felt like I was entering a vortex, and things were getting faster and faster and more compressed the closer

er we got to Comdex," Keely says.

Adding to the pressure, the new batch of tablet prototypes turned out to be flaky as hell. The batteries wouldn't hold a charge, and the screens could go dark if touched in the wrong place. Keely accidentally hit the power button during a practice demo and shut a tablet off. Any kind of glitch during a high-profile product demonstration would spoil a technology debut. Charlton, the lead software developer on the project, had a spare tablet on hand. Keely could quickly grab one if the prototype he used crashed.

Luckily, that tablet turned out to be unnecessary. Keely's machine worked flawlessly, and the no-savvy Comdex

audience applauded as he strutted the stuff. Some of the coolest features included cutting handwritten words into sentences and having the entire screen and even paragraphs, slide together in the space. Lui, who has been working for years on handwriting technology, called it one of the greatest moments of his life. "It was like I was floating in space, looking down on earth," he says.

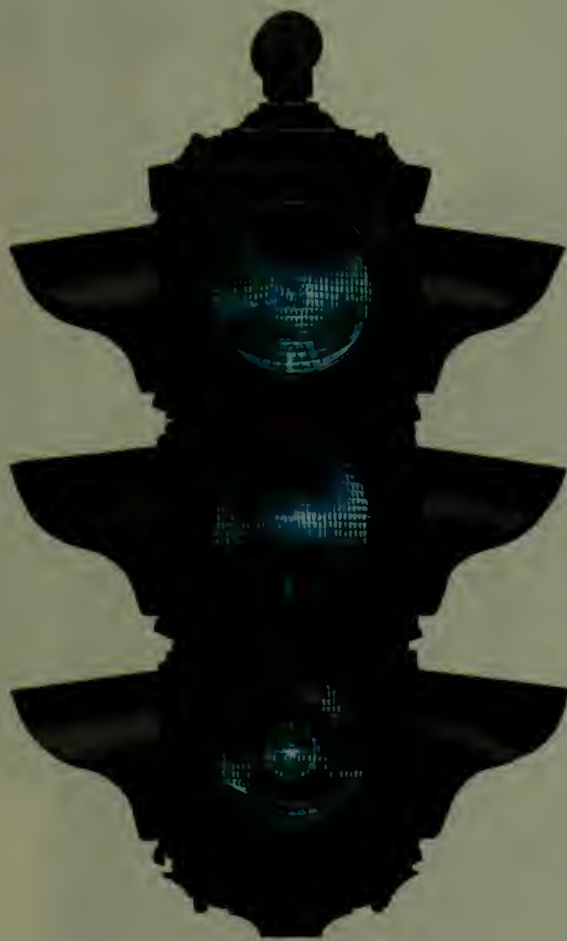
The euphoria didn't survive field tests, though. In February, about 30 users at three Minneapolis companies, including U.S. Bancorp, swapped laptops for tablets. Microsoft dispatched teams of tablet staffers to follow for several hours each day. The experience was so consuming that ace usability expert Evan Feldman spent seven days in Minnesota, even missing his daughter's 7th birthday.

The findings were horrifying. The clever technology that wowed the Comdex audience drove users into a frenzy. Workers routinely took notes that had no relation to the lines on the tablet page. They would scrawl diagonally right next to notes that were horizontal. Sentence fragments merged crazily.

The technology that caused the problems was among the most brilliant computer-science work on the project. Ultimately, Feldman persuaded Loeb to dump it. "No magic is better than magic," Loeb says.

Story continues on page 62

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TELECOMMUNICATIONS

SAVING ERICSSON

Can Kurt Hellström redesign the staggering giant?

During summer, 2001, Loeb got even more nervous. Gates peppered her with e-mails about fundamental features such as the quality of the handwriting-recognition technology. Loeb feared he might pull back on the planned 2002 launch. She called a "come-to-Jesus" meeting in August in Gates's conference room, with two dozen execs from the Tablet PC, Office, and Windows groups to answer any questions Gates might have.

At the meeting, tensions surfaced between the Tablet PC and Office groups. Office executives wanted to focus on producing the next version of their applications, including Word and Excel, due two years later. But Loeb's team and Gates believed that the initial success of the tablet depended on having handwriting features in Office when the tablet launched. So Gates called for the tablet team to develop an "add-on pack," a collection of Office features designed specifically for the tablet. Then he gave the project the green light for 2002.

Gates even did some evangelizing of his own. In September, 2001, Hewlett-Packard Co. agreed to buy Compaq Computer Corp. While both had been solid Microsoft allies for years, only Compaq had agreed to make a tablet, so Gates wanted to make sure the merged company went ahead full steam. On June 10, Gates met with HP boss Carleton S. Fiorina and No. 2 Michael Capellas to talk about the merger. "To one of those meetings, I brought my tablet, which was an Acer, and took notes and kept enthusing about how, 'I don't think you're going to make enough tablets,'" Gates says with a smile. HP is a believer, and will be a major presence at the launch.

In August, Microsoft finished the software development for the tablet. The entire team partied the Thursday before Labor Day at one of the campus cafeterias. Keely's band, the Flying Other Brothers, rocked the crowd.

While the team put the finishing touches on its software, Gates made the tablet his indispensable tool around the office. It took a while for him to trust the machine. During the first weeks that he had the Acer test version, he still brought pads of paper along to meetings for note-taking along with his tablet. At one meeting in July, Microsoft CEO Steven A. Ballmer chided him. "That tablet must not be very good yet," Gates recalls Ballmer saying. When Gates defended his tablet, Ballmer challenged him to leave his paper behind next time. After a few last fixes were made to the software, Gates did just that. Now he's betting the rest of the business world will follow suit.

By Jay Greene in Seattle, with Andrew Park in Dallas

Ask investors what Ericsson's business is, and you'll probably get the usual answer: It's the No. 1 seller of wireless telecom networks in the world. And oh—by the way, that business is in deep, deep trouble. Ericsson revenues this year will be 40% less than the record \$24 billion booked two years ago. And losses? More than \$5 billion total for last year and 2002. That's why Ericsson's widely traded B shares now sell for under a dollar. Sweden's most important company, in other words, is a penny stock.

But if CEO Kurt Hellström has his way, such ignominy won't be the final chapter. You can already get a glimpse of Ericsson's future in some far-flung corners of the empire. Just stop by the operations

center of O₂ Netherlands, the Dutch wireless subsidiary of Britain's MM_O₂, for example, and you'll see workers in Ericsson T-shirts hunched over computer workstations monitoring the nationwide network. These 240 technicians aren't employees of O₂. They're an all-Ericsson team, permanently based at O₂ to run the wireless network lock, stock, and barrel—Ericsson, the company-for-hire. For this traditional maker of big network systems, it's a huge change.

There are more surprises. Ericsson once proudly made all its own products and hoarded the fruits of its research & development. But Hellström knows pride doesn't produce profits. So he has passed off a majority of Ericsson's manufacturing—more than 5,000 of its employees contracting outfits like Flextronics International and Soletron. Even more startlingly, he's outsourcing some of Ericsson's R&D to more cost-effective contractors. Indian software powerhouse Wipro now runs Ericsson's software in New Delhi, Hyderabad, and Bangalore. At the same time, Hellström opened new units to license the company's technology to rival companies worldwide. In other words, the Swedes are renting out the crown jewels. They even handed off their mobile handset business to a joint venture with ex-Sony Corp.

A fundamental shift is going on in this hidebound place. The result could transform Ericsson into a new kind of company: a wireless specialist that depends on services more than manu-

The company's woes are hammering Sweden Inc.

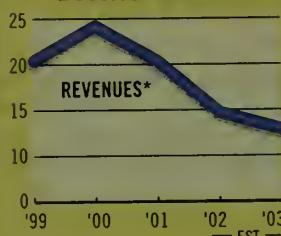
MARCUS AND JACOB WALLENBERG ARE STILL LOYAL INVESTORS





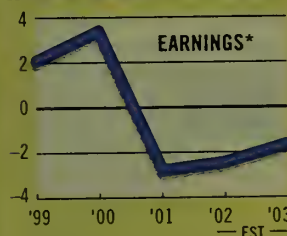
GRIM: "I can imagine better situations"

DIVING SALES...



▲ BILLIONS OF DOLLARS
*EXCLUDES HANDSET SALES, NOW PART OF SONY ERICSSON

...AND HUGE LOSSES...



▲ BILLIONS OF DOLLARS
*EARNINGS BEFORE INTEREST AND TAXES

...ARE HITTING ERICSSON'S STOCK



▲ DOLLARS
Data: UBS Warburg, Bloomberg Financial Markets, BusinessWeek

with mug shots of the job-slashing CEO. "People have done a really good job, and as thanks we get big layoffs," says Peder Bostrom, head of the metal workers union in Kumla, a town of 19,000. Ericsson's plant there has lost 2,350 of its 3,200 jobs in the last two years, in some cases leaving families without a breadwinner. Analysts say the cuts announced so far should be enough to return Ericsson to slight profitability in 2003 unless wireless-equipment spending falls even further than expected. But that's cold comfort in Kumla.

The company's woes—and those of the business ecosystem that sprang up around it—have shaved about 0.5% off Swedish gross domestic product, according to Klas Eklund, chief economist of Stockholm bank SEB. Ericsson's near-death spiral has also hammered the portfolio of Investor, the publicly traded holding company of the powerful Wallenberg clan, which controls the biggest chunk of Ericsson stock. The Wallenbergs are standing firm. "Investor has actively supported management in very challenging market conditions," says Marcus Wallenberg, CEO of Investor as well as deputy chairman of Ericsson. But the loyalty exacts a

price: Investor shares are down 54% this year, to the dismay of Wallenberg and his cousin Jacob, who jointly preside over the family's interests.

You would think Hellström would be a burnt-out wreck dealing with all this adversity. Yet on a recent fall afternoon in London, he seemed fresh and sharp and didn't hide his sardonic sense of humor. Commenting on what seems his quixotic quest to save Ericsson, Hellström replied with a grim laugh: "I enjoy being beaten up." He's convinced Ericsson has a healthy future if he can just guide it through its crisis.

That future, however, will be starkly different from Ericsson's glorious past. Revenues grew fivefold from 1991 to 2001—a compound annual rate of 17.5%. Now, demand for traditional wireless equipment may not pick up for another half-decade, while the growing commoditization of communications hardware could permanently weaken margins. Turning a group of proud engineers

g, on knowhow more than metal. If transformation requires deconstructing Ericsson, so be it. "I can imagine better situations to be in," Hellström says. "But the job has to be done." The urgent question is whether Hellström has the time he needs to do that. Just check out the ghastly numbers reported on Oct. 18. Ericsson lost \$1 billion, as third-quarter shipments dropped almost a third from 2001 levels, to 3.62 billion. New systems orders fell 49%, and there are some signs Ericsson may be losing share to rivals such as Nokia Corp. and Lucent Technologies. Ericsson's bet that operators would roll out new 3G wireless systems has proven disastrously wrong. True, shares have jumped 22% since the earnings announcement after Ericsson's executives said that costs were declining according to plan. But that rally just wiped the shares to all of 74¢. At their peak in March, 2000, Ericsson shares traded at nearly \$19.

Hellström is trying to build a future for the company while scrambling to survive a hellish present. Since being drafted back from a choice Hong Kong sales posting in 1999 to become Ericsson's president and later CEO, Hellström has had to lay off 40,000 of 110,000 workers, with an additional 10,000 to come. In August, he had to tour Europe and North America with a begging bowl, raising \$3.1 billion in a fire-sale stock issue to keep Ericsson afloat. Patriotic Swedes ponied up much of the dough. "I talked to a lot of small shareholders," says Chairman Michael Treschow, who joined Ericsson in April after turning around domestic appliances maker Electrolux. "There was a lot of emotion, a lot of national pride."

But don't mistake patriotism for affection. Hellström is a lightning rod for criticism in Sweden. He's regularly vilified by the tabloid press. Last year, one paper even made its front page into a mock "Wanted" poster, complete

Ericsson needs more equipment orders to fill the gap until services pick up

into the leaders of a new service industry will require a huge cultural shakeup. Inside Ericsson, cynicism runs high. Says one senior engineer: "They keep talking about reorganization and giving better service to customers, but we don't take it seriously."

Doubts about Hellström's plan even extend to the board of directors. "I don't think there is clear leadership," one board member says, "and there isn't agreement on the board about what should be done to try to turn the company around." In response, a company insider says the atmosphere on the board is better since Treschow's arrival and that the board realizes replacing the CEO now would spook the markets.

Such uncertainty isn't stopping Hellström from carrying on with his makeover. His strategy of selling services and basic technology bears a remarkable similarity to the model pursued by former IBM CEO Louis V. Gerstner Jr. during its turnaround in the 1990s. No wonder: The situation facing telecom today is eerily like that which confronted the info-tech business a decade ago. Proprietary products are being superseded by cheaper open systems built from off-the-shelf parts. Vertically integrated giants such as Ericsson, Lucent, and Nortel Networks are being undercut by newcomers such as Cisco Systems and even rising Chinese star Huawei Technologies, just as IBM and Digital Equipment were battered by low-cost PCs from Dell Computer. As in the computer industry, the "value" in telecom systems is shifting from hardware to software and services. Operators used to spend 80% of their capital budgets on hardware and just 20% on software, says Amrish Kacker, a senior consultant at researcher Analysys Consulting in Cambridge, England. Now, software is on track to top 35%.

Hellström also has to improve Ericsson's returns if it ever aspires to become a growth stock again. Return on capital in 2001 plunged to -14%, down from 25% in 2000 and far less than the 28% logged by Nokia. That's why Hellström and crew now have to

slaughter a lot of sacred cows. Ericsson is eliminating 70% of its operating units, and consolidating back-office functions into regional centers. He's also slicing R&D in half by closing three-quarters of Ericsson's labs and phasing out work on antiquated mobile technologies. Most shockingly, he's walking away from Ericsson's legacy, winding down investment in traditional circuit-type telephone switches.

The blunt-spoken Hellström, 59, made his name at the company as a sales whiz

with a magic touch at preaching wireless gospel to the world's big telco operators. As CEO, his dark assessments of the state of the industry have given him a new dimension of notoriety. "I want to tell the truth as I see it," he says. "Even if it is harsh, I don't try to sugarcoat it." He's unhappy but not mawkish, at least about layoffs. "We don't have the option of doing nothing," he says.

This summer's stock-rights issue pushed the company's cash hoard to more than \$7 billion and effectively eliminated net debt. Problem is, Ericsson still depends too much on a recovery in equipment orders that may well not occur. Soft demand and pitched competition from desperate rivals such as Lucent, Nortel, and Alcatel have driven prices

for wireless equipment down by as much as 30% in the past year. Even if Ericsson holds onto its third share of the shrinking business, it faces a revenue decline of more than \$15 billion, in the space of just 36 months.

Will services and software come to the rescue? "Ericsson can certainly say it has the skill to manage the transition," says analyst Lesieur of Technology Business Research Inc. in Hampton, N.H. On Oct. 1, Ericsson scored a \$100-million contract to upgrade China Unicom's mobile network—even though most of the equipment will come from rivals Lucent, Motorola, and Nortel.

Of course, battered rivals are also chasing services business and winning contracts, such as a \$40 million job awarded last July to Alcatel to manage the wireless network at Austria's Telekom Service.

Hellström has another asset to exploit—a vast wealth of 10,000 technical patents, including technology for hot properties such as Bluetooth short-range radio. One company unit now sells kits enabling other companies to churn out handsets based on Ericsson models. Another unit pursues licensing deals for communication technology. Designs have been licensed to six companies, including LG Electronics of South Korea, Samsung of Taiwan, and TCL Group of China.

ERICSSON RETOOLS

A sickening plunge in sales of wireless equipment is forcing management to cut costs and seek new revenue sources

SLASHING WORKFORCE From 110,000 employees in 2001, the number will be cut to 60,000 by 2003.

STREAMLINING Layoffs and consolidation of back-office functions should halve expenses nearly in half by 2003, letting Ericsson break even on sales of \$12 billion.

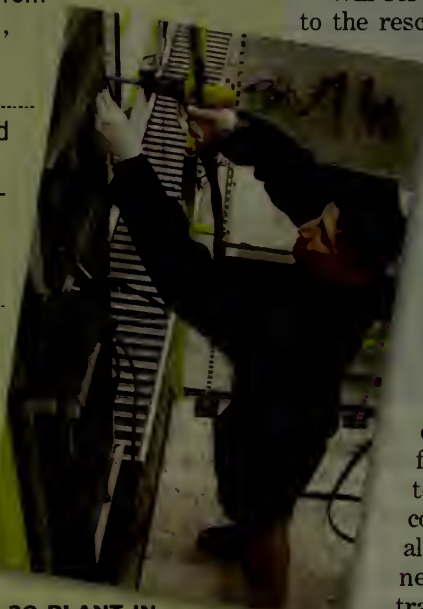
WHACKING R&D Exiting three aging businesses and closing 75% of its research labs will cut spending in half in two years.

RIGHTS ISSUE The company raised \$3.1 billion this summer through a stock-rights issue. Shares outstanding doubled, but the company has eliminated net debt and has a solid \$7 billion in cash on hand.

ASSET SALES Ericsson has disposed of \$1 billion in real estate and \$3.5 billion in businesses and holdings in the past two years.

SERVICES From just 16% of revenues in the first half of 2001, Ericsson has expanded sales of services such as network consulting and operations to 23% of its total. By 2005, it aims to get one-third of revenues from services.

MINING FOR GOLD Ericsson hopes to profit from hawking its 10,000-strong patent portfolio and a century of experience in telecom-system design.



3G PLANT IN GAVLE

Data: Company reports, BusinessWeek

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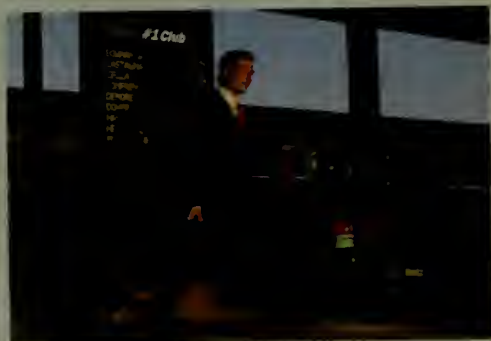
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If Hellström can't stop the cash burn, he may have to get out the begging bowl

as well as to Ericsson's 50/50 handset joint venture with Sony (box). Revenues are only a blip so far, analysts say, but with nearly 100% margins, licensing could be lucrative.

If all of Hellström's efforts aren't enough to stem the cash burn, the begging bowl may have to come out again. Investors next time would likely balk, especially since they are still uneasy about the company's unusual ownership structure. Quietly, Hellström, and especially Treschow, are now working to fix it. The issue: The company's two main

shareholders, Investor and Industrivarden, a holding company affiliated with Stockholm bank Handelsbanken, control close to 78% of the votes at the company despite owning only about 11% of the equity. The two groups maintain their grip through special A shares that have 1,000 times the votes of ordinary B shares. The setup has proven a handicap of late. When Ericsson asked institutional investors for new capital this summer, they wondered why they should ante up for a company that they couldn't influence.

To allay such concerns, Invest Industrivarden are considering a change in the voting ratio of A to B from 1,000-1 to 10-1, which would reduce their control of votes to about 30%. "The ownership question is a problem," says Marcus Wallenberg. It can be a minor distraction in negotiations with the financial markets. Treschow thinks a change might make Ericsson shares more attractive abroad. "There might be more participation by international investors who don't understand our conditions," Treschow says. Those conditions are looking increasingly outmoded. Swedes may find Hellström's medicine hard to take for Ericsson, there is no choice.

By Stanley Reed and Andy Reinhardt, with Ariane Sains, in Stockholm

SONY ERICSSON: "IN BIG BLOODY TROUBLE"?

Alexandre Rito, a salesman at the FNAC electronics store on Paris' Champs-Élysées, can't hide his excitement over the new phones from Sony Ericsson Mobile Communications. Snazzy products from the year-old joint venture between Japan's Sony Corp. and Sweden's Ericsson have polished the image of Ericsson's handsets. Indeed, FNAC's best-seller is the Sony Ericsson T68i, whose color screen, sleek design, and optional digital camera add-on pull in droves of buyers. "Customers are really happy with it," Rito says.

If only Sony Ericsson could bottle that buzz and sell it. Problem is, despite enthusiasm for the venture's products and potential, it's not yet producing results. Global market share has been stuck at around 5% for the past nine months, half what the two companies separately tallied in 2001. Worse, it's still losing money—\$100 million last quarter—which could force its corporate parents to kick in more funding early next year.

Sony Ericsson's bosses profess not to be worried. "I'm very happy with our progress," says Executive Vice-President Jan Wäreby, a former Ericsson manager who runs the company's headquarters in London with CEO Katsumi Ihara, a Sony transplant. Analysts aren't as sanguine. Richard Windsor of Nomura Securities Co. figures the venture won't turn a profit unless it doubles its market share from a current

5%. "They're in big, bloody trouble," he says.

It wasn't supposed to work out this way. After all, the deal combined Ericsson's tech prowess and links to wireless operators with Sony's talents in consumer electronics and marketing. Each also figured to help the other grow in regions where they weren't as strong—Europe for Sony and Japan for Ericsson. The sweetener: Sony's media holdings in



Hot seller: A striking design, but not enough to produce profits

WAREBY, IHARA, AND THE T68i

film, games, and music would provide a source of snazzy content to drive sales of new wireless services.

It sounded great on paper. But soon after the venture kicked off, reality set in. Unifying two product lines and different engineering cultures took longer than expected. Execution problems caused delays in new phones. "They're having a horrible 2002," says Gartner Dataquest mobile analyst Ben Wood.

Now Sony Ericsson is fighting back. On the heels of its T68i, the company has delivered another high-end phone and two low-end models. The competition isn't sleeping, though. Nokia is flooding the market with new models. And on Oct. 22, European wireless carrier Orange PLC rolled out a private-label phone made by Taiwan's High Tech Computer Corp. that's the first to use Microsoft Corp. Smartphone software.

Such operator-branded phones could undermine Sony Ericsson's margins and amplify the threat posed by Microsoft's entry into the mobile software business. Gartner's Wood thinks Sony Ericsson will eventually gain ground thanks in part to Sony's media magic. Question is, can it make money soon enough to satisfy its impatient parents?

By Andy Reinhardt in London, with Karim Djemai in Paris



ALL THE PAYING S FINALLY GOING TO PAY OFF

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COMMENTARY

By Margaret Popper

A BETTER WAY TO STIMULATE

The economics profession is deeply divided about the usefulness of fiscal policy. While few doubt that tax cuts and increased government spending can spur growth, critics say that politicians are likely to opt for worthless pork rather than measures that do the most for the economy.

That may be true. But with the economy turning sluggish, there are two possibilities for effective fiscal stimulus that might get the vote of both politicians and economists. First, the federal government could boost transfers to the states to head off looming budget cuts. Second, Congress could beef up the tax benefits for business investment that were enacted in March, 2002.

Together, the measures could inject \$50 billion or more into the economy—enough to keep the recovery on track. They also address two big problems—state budget reductions and lethargic capital outlays. Caught in a crunch, state governments are slashing spending in a way that will hurt growth. And cash-strapped companies need all the help they can get to pay for capital spending.

Certainly other proposals are on the table in Washington for pumping up growth. Republicans are talking about eliminating double taxation of dividends, for example, while leading Democrats have suggested such ideas

as giving companies that hire next year a break on their Social Security contribution.

But focusing on funds for the states and tax cuts for business investment offers a lot more bang for the buck—and here's why. With revenues plummeting, state government budget deficits would run as high as \$60 billion for the fiscal year ending in June, 2003, without spending cuts, according to the National Conference of State Legislatures—and by law most states aren't allowed to borrow to fund budget gaps.

"This is the worst fiscal crisis of the states since 1972," observes Richard P. Nathan, director of the Nelson A. Rockefeller Institute of Government in Albany, N. Y.

As a result, economists are predicting that state and local governments will reduce spending by 2% to 3% over the next year, which could mean a decrease of at least \$30 billion. The programs that will be hardest hit are Medicaid and

higher education. Tax hikes are on the agenda as well; already 16 states have raised taxes, dragging down consumer spending.

Avoiding further tax increases and spending cuts at the state level will require added funds—perhaps enough to make up the \$30 billion spending shortfall—from Washington. The funds could be directed to specific programs, such as Medicaid, or could be left to the discretion of the states. "If the federal government were to step into this crisis that the states are facing, it could avoid some of the counterproductive moves they are making," says Alice M. Rivlin, senior fellow at the Brookings Institution.

The other thing Congress should do is give companies a bigger first-year tax write-off on any equipment they buy in 2003—and set it up so that the benefits are higher if they make the purchases sooner rather than later. That would push companies to move more quickly than under current rules.

A tax break for 2003 spending would cut companies' financing cost by 6% to 8% next year—twice as much as under the current provision says Kevin A. Hassett, an economist at the American Enterprise Institute. That translates into added capital spending of \$30 billion to \$40 billion. Such a break should overcome the natural hesitancy of managers amid lots of uncertainty. The key is to coalesce planned spending into the next quarter or two, creating the momentum the recovery needs.

These proposals may have political advantages as well. Pushing spending

down to the state level appeals to both conservatives and liberals. And a limited tax reduction for capital spending could attract both Republicans and Democrats.

The economic wrangling over the virtues of fiscal policy may never be resolved. But in the real world, Congress has a chance to take steps that could help a struggling recover

WASHINGTON: TRY THESE PICK-ME-UPS

STATES

PROBLEM Facing big deficits, states are cutting outlays and raising taxes. That could dent consumer spending.

SOLUTION Greater federal transfers to states to help pay for Medicaid, education, and infrastructure.

BUSINESS

PROBLEM Corporate capital spending is still weak.

SOLUTION Tweak the tax code to reward companies that ramp up investment in 2003.

Popper writes about the economy from New York.



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IS THIS BUD FOR YOU, AUGUST IV?

The Busch dynasty has its first non-family CEO. But the eldest son may yet inherit his father's crown



"The King of Beers" may be the slogan of Anheuser-Busch Cos.' flagship brand, Budweiser, but it could just as easily describe any of the company's chief executives of the past century-and-a-half. Until this past July, all in that illustrious group had been named Busch, and if the family has its way, the current aberration will be extremely temporary.

At a time when the image of the regal boss is more than just troubling, the Busch family seems somehow exempt from many of the rigors currently being imposed on the rest of Corporate America—even though the two most prominent family members own only about 1% of Anheuser-Busch. August A. Busch III, perhaps the shrewdest, sternest Busch to emerge since Adolphus Busch took control of the St. Louis brewery in the mid-1880s, has begun a succession process as tightly orchestrated as any in the House of Windsor. After 27 years as chief executive, Busch III has relinquished his operating titles, although he remains chairman. And here, one supposes, is his concession to today's pressures: He deemed his eldest son, 38-year-old August A. Busch IV, not yet prepared to take over the \$15 billion company. Hence the July 1 appointment of longtime A-B executive Patrick T. Stokes as CEO.

That gives the Fourth, as he's called, roughly five years to prove himself before Stokes, who's 60, retires. Busch IV has worked at the family company for about two decades. Over the past sev-

INTERREGNUM: WASSUP?

Busch III deemed "the Fourth" not ready to take over the company. He has five years to prove himself



years, he has played a crucial role in inventing A-B's marketing, showing instinctive understanding of the kind of advertisements that stir young men. Budweiser bullfrogs came to life on his watch, as did such tropes as "sup." Even rivals acknowledge that the company in recent years has produced the most consistently inventive advertising in the U.S. But the company hasn't yet made a name for himself in any other way: He has never expanded the company's network of American U.S. breweries, managed its correlations with independent whole-



salers, or run its international and theme park units. And even though he's approaching 40, he still has a reputation as a party boy, which could be a problem for the head of a brewery. Busch IV also had a serious brush with the law in college.

As Stokes moved into the chief executive's office, Busch IV was given responsibility for the corporation's crown jewel, the domestic beer operations. When asked about his future, the Fourth says: "I don't take anything for granted in this company. It's not a foregone conclusion that I'll go any further."

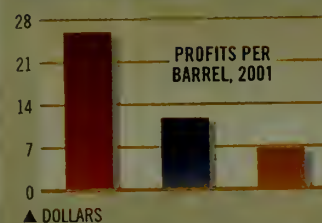
He's not just being modest. His 25-year-old half-brother, Steven Busch, is emerging as a potential rival. Steven is known to be smart, hardworking, and serious. He's considered a long shot, but A-B has a long history of sibling warfare for the top spot. For now, few are willing to hazard a firm prediction on how the Fourth would fare in a bigger role. "August Busch IV is a little bit of a dark horse," says Caroline S. Levy, a beverage analyst at UBS Warburg. "Wall Street doesn't know how bright he is, how good a leader he is. He's not a character who has been tested or tried."

What makes this family drama all the more critical is that the beer business is shifting in particularly challenging ways. Under Busch III, now 65, A-B has been a domestic juggernaut, grabbing market share, mainly from its floundering archrival, Miller Brewing Co. Today, fully one-half of the beer consumed in the U.S. comes from Anheuser-Busch; domestic beer accounted for 77% of A-B's \$12.9 billion in sales last year. That huge scale has allowed it to achieve efficiencies in brewing, distribution, and advertising that have brought it a disproportionate share of the industry's profits. A-B's annual earnings have grown an average of 8.5% since 1996, to \$1.7 billion in 2001. During that time, the company's stock has risen 61% as the Standard & Poor's 500-stock index has stayed flat. In the third quarter, A-B's net income rose 11%. That's no mean feat in an industry that's growing by less than 2% a year.

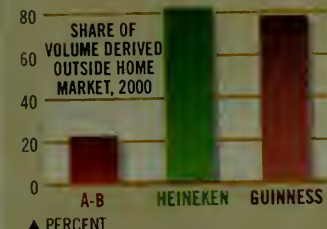
ANHEUSER-BUSCH DOMINATES AT HOME...



...AND MAKES A BUNDLE ON EACH BARREL OF BEER...



...BUT OVERSEAS, IT'S STILL A PIPSQUEAK



Data: Beverage Marketing Corp., Impact's 2002 Beer Study, Impact's 2001 Global Drinks Study, BusinessWeek

But Busch III has run the company with a heavy hand. His treatment of those who cross him, from wholesalers to rivals, is swift and rough. That aggressive style may have helped propel the company to dominance, but it has also exacted a price, particularly overseas, where the brewery will have to seek more of its growth in the future. It is few companies' first choice for a partner; its most important relationship, with the Mexican brewer Grupo Modelo, was strained for years because Busch III treated Modelo as a rival rather than an ally. Indeed, A-B has largely been left out of the industry's increasingly rapid global consolidation—capped by Miller's recent \$5.6 billion merger with South African Breweries, a move that catapulted SAB to No. 2 in volume worldwide. Busch IV's less astringent manner could help

him forge the strategic relationships his father couldn't.

The Anheuser-Busch board has posed few challenges to Busch III's authority, and that goes for his succession plan as much as anything else. Anheuser-Busch's strong performance over the past five years has no doubt kept many directors quiet. "They think: If the family can run a company that is the world leader, keep the Busches coming," says Patrick Schumann, an analyst at Edward Jones in St. Louis.

But it's not a board known for its independence. Twelve of the 15 directors are outsiders, but some have ties to the company or to the Third that diminish their autonomy. SBC Communications Inc. Chairman Edward E. Whitacre Jr., Emerson Electric Co. Chairman Charles F. Knight, and Busch III all sit on each other's boards. A-B contributed at least \$100,000 last year to Girls Inc., a charity run by director Joyce M. Roche. Until director Douglas A. Warner III retired as chairman of J.P. Morgan Chase & Co. in November, 2001, he headed a firm that provides investment banking services to A-B. And several years ago, Knight's son, Steven, was awarded a lucrative distributorship in Kent, Wash.

No outside board member would comment for this story; nor would August

III, Steven Busch, or other family members. But Stokes, who is an executive board member, rejects the very notion of a Busch dynasty and denies that the directors are mere bystanders. "I disagree with that opinion, and the board would disagree. We take very, very seriously our obligation to have the right person in the job."



At a time when corporate boards ignore governance issues at their peril, the directors could be roused to consider other candidates for CEO, especially if the company's performance falters. Some investors believe the board will have to become more involved in the selection process. "Before a year ago, it would have been easier for August IV," says Cori B. Johnson, a portfolio manager for U.S. Bancorp Asset Management, one of A-B's largest institutional shareholders.

At the least, investors, wholesalers, and potential partners are likely to more closely scrutinize the Fourth's actions for signs of maturity, even statesmanship. In the brewing business, which must constantly fend off efforts to ban beer advertising, a central role of the CEO is to make the case, in Washington and elsewhere, that brewers are marketing their products responsibly.

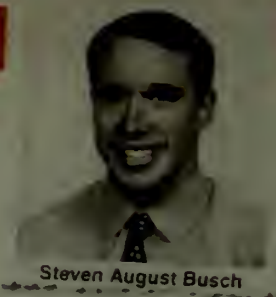
Busch IV's reputation as a hard-partying guy could be a hindrance in this regard. Guests at some of his frequent parties describe his home, once owned by hockey star Brett Hull, as the ultimate bachelor pad, with beer taps in the kitchen and a giant hot tub. Others say he's often accompanied on business trips by female companions. "It's interesting seeing all the young women," says a bemused Bob Scarpelli, chairman of ad agency DDB Chicago. "It's kind of like hanging out with a rock star."

Busch, who has never been married, says his house is comparable to that of any executive and that he pays the expenses of any guests who travel with him. He also says that he engages in "responsible consumption of our products." And, he adds: "I didn't get where I am today without performing."

But the partying hasn't al-

ways been so benign. While at the University of Arizona in 1983, he had his own Chappaquiddick-like scandal: Early one morning, police found a young woman, Michele Frederick, dead in

Busch's wrecked Corvette and Busch in his Tucson townhouse, dazed. Busch and the woman had been at a bar before he crashed the sports car. Busch was never charged with a crime and has previously denied that alcohol played a part in the accident. But with the beer industry under constant attack for promoting irresponsible drinking, Busch knows he can't put the incident completely behind him. "That's a chapter that's never gone, that I will always remember," he says. "But I honestly believe that, as painful as that memory is, that experience will make me a better keeper of responsibility for our products."



Steven August Busch

RIVAL? August IV's brother, Steven, is deeply immersed in the business.

If he's wrong, his father won't have to look far for another Busch to lead

company. Steven is just 25, but he's already immersed in the business. While still a student at Washington University's business school, Steven worked as his father's assistant. They enjoy a relationship that the elder son never shared; and the Fourth describes his relationship with his father, who divorced his mother when he was 5, as distant.

Some folks close to the family, however, say Steven's mother, Virginia, who is currently married to August III, has no secret of her wish to see her son take over the company. "For the past several years, the Fourth has said openly that his stepmother wants him to fail and

son Steve to run the joint," says one such person. "I don't know if that's true, but it's true that the Fourth feels that way." Of course, at this point Steven is far too inexperienced to be a contender. Stokes dismisses speculation as gossip. Ask August IV about his half-brother and he will only say: "He spends a great amount of time with his father, he's a very smart guy, he does a great job for my father. Other than that, I really can't comment." Steven's likely next position at A-B? "I don't know," he says.

While even rivals acknowledge that the Busch family's control of A-B has helped foster a long-term orientation, it has come at a cost. As A-B has amassed increased muscle, it has be-

come hard to separate its strategy from the explosive temperament of Busch III, or "Three Sticks" as he's called behind his back. After an outburst in a Hawaii supermarket in 1995—he hit the roof when he found the store adorned with signs for other brews carried by the local wholesaler—A-B revamped agreements with wholesalers, financially penalizing those who didn't abandon all other brands.

Many wholesalers resent the loss of control—these days A-B even gets deeply involved in their succession plans—

AUGUST A. BUSCH IV

BORN June 15, 1964, St. Louis.

EDUCATION BS, business, St. Louis University, 1987; brewer's license, 1988; MBA, St. Louis University, 2000.

CAREER PATH As the eldest son of August Busch III, he was deemed the heir apparent at Anheuser-Busch right from the start.

CURRENT JOB President of U.S. brewing unit of Anheuser-Busch since July.

HIGH POINT Revitalized Budweiser's marketing with inventive approaches—including the bullfrog and "Wassup?" ads—that helped refresh the brand's image among the all-important twentysomething male contingent.



LOW POINT Car accident while in college in which his female passenger was killed; they had left a bar in Tucson together. Busch IV never faced charges.

BIGGEST CHALLENGE Showing he has the smarts and maturity to handle the complexities of his new role and, one day, those of the CEO.

ON HIS FATHER "I love my father. But he has been extremely tough on me."

ON HIS FUTURE "I don't take anything for granted in this company."

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they can't argue with the result. According to Busch IV, its wholesalers average far higher operating profits per case than rivals who juggle many brands. And A-B doesn't let anybody forget that: Some distributorships are bestowed as rewards, others are rescinded as punishment. Today, 61% of A-B volume goes through exclusive wholesalers; in 1996, it was only 40%. The company's clever advertising may get the most attention, but "the wholesaler system is where the company has its edge," says Jeff Kanter, an analyst at Prudential Securities Inc.

Still, the Third's behavior has hurt the company overseas. Just ask Grupo Modelo, the Mexican owner of Corona beer. Since A-B owns a 50.2% stake in Modelo (though it doesn't have voting control and it isn't Modelo's U.S. importer), it has profited handsomely as Corona has become the No. 1 import in the U.S. Last year, A-B's equity stake in Modelo accounted for 14% of its net income. Until recently, though, A-B regarded Corona as a threat, and did all it could to derail the brand. The compa-

ny financially penalized wholesalers who carried it and ran ads warning consumers that beers in clear bottles are likely to be stale. It even went so far as to launch two Mexican-style brews to challenge Corona.



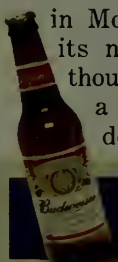
The lesson stemming from A-B's partnership with Modelo—along with its lax management of Denmark's Carlsberg and Japan's Kirin—has not been lost on other companies. For years, Busch III has been promising wholesalers a European import to fill that crucial gap in their portfolio, but no one has been rushing to do business with A-B. It has fared better in forging licensing agreements in such markets as China and Italy, but those don't yet contribute significantly to sales. "Typically, they go out and piss people off, because A-B wants it all," says a former company executive. "That's where their family lineage has hurt them, and that includes Stokes."

The fact that the Fourth is less belligerent than his father could help him build global alliances. Already, he has helped defuse tensions with Carlos Fernandez, Modelo's 36-year-old CEO and a

member of A-B's board. Busch IV acknowledges as much, though caretaker he says. "That doesn't mean I'm less or more effective than he is, but I am different."

To satisfy shareholders, Busch IV has to keep the cash-generating domestic beer unit humming. But much more Bud can A-B sell? Besides the real action now is in booming ports and other high-price beers. Over the years, the company has tried to develop craft brews and flavored "malt beverages" but hasn't had much success. Its latest such attempts: the malted Bacardi Silver and low-carbohydrate brew Michelob Ultra. When asked about the challenges he now faces, the Fourth says: "If we are able to do what we want to do here—which we will do, because failure is not an option—that will provide the resources needed to fulfill a broad international portfolio."

He chuckles as he says that, because his dad is always declaring that "failure is not an option." While the Fourth reveres his father, he admits theirs has been primarily a business relationship,



KINGS OF SUDS

1861 Adolphus Busch, a German immigrant, marries Lilly Anheuser. He goes to work at her father's Bavarian Brewery in St. Louis.



1920 Prohibition begins. Under President August A. Busch Sr., who succeeded Adolphus upon his death in 1913, A-B diversifies into ice cream, root beer, corn syrup, and a low-alcohol Budweiser. It survives a vicious consolidation: Of the 1,400 American breweries operating in 1914, only 323 remain open after Prohibition.

1933 Prohibition ends, and the nation goes on a beer-drinking binge that pushes A-B's annual production to more than 2 million barrels. Clydesdale horses mark the occasion with a beer delivery to the White House—their first appearance as a company symbol.



1934 Tormented by illness, August A. Busch Sr. (above) commits suicide, setting off years of succession drama. Oldest son Adolphus Busch III takes over but is upstaged by restless younger brother August A. "Gussie" Busch Jr. Upon Adolphus' sudden death in 1946, Gussie ascends and creates a network of regional breweries.

1957 A-B surpasses Schlitz to become the nation's No. 1 brewer. In 1959, Gussie opens the 13-acre garden surrounding his Tampa brewery to the public as Busch Gardens. Today A-B's entertainment businesses bring in more than \$800 million annually.

1975 Demanding a bolder response to fend off a growing challenge from Schlitz, 38-year-old August A. Busch III orchestrates a boardroom coup to oust his father, Gussie, as chief executive.

1982 A-B unveils Bud Light, finally responding to Miller Lite, which capitalized on America's new health consciousness. Bud Light surpasses Lite by 1994, and by 2002 it leapfrogs Budweiser to become the No. 1-selling U.S. brew.

1995 With August A. Busch IV serving as marketing vice-president, Budweiser reinvigorates its marketing by airing a new TV spot featuring bullfrogs who mouth the syllables "Bud-weis-er."

July, 2002 Busch III steps down to become nonexecutive chairman, succeeded as CEO by his longtime associate Patrick Stokes (right). Busch IV is given control of the U.S. beer business, and his audition for the top job begins in earnest.



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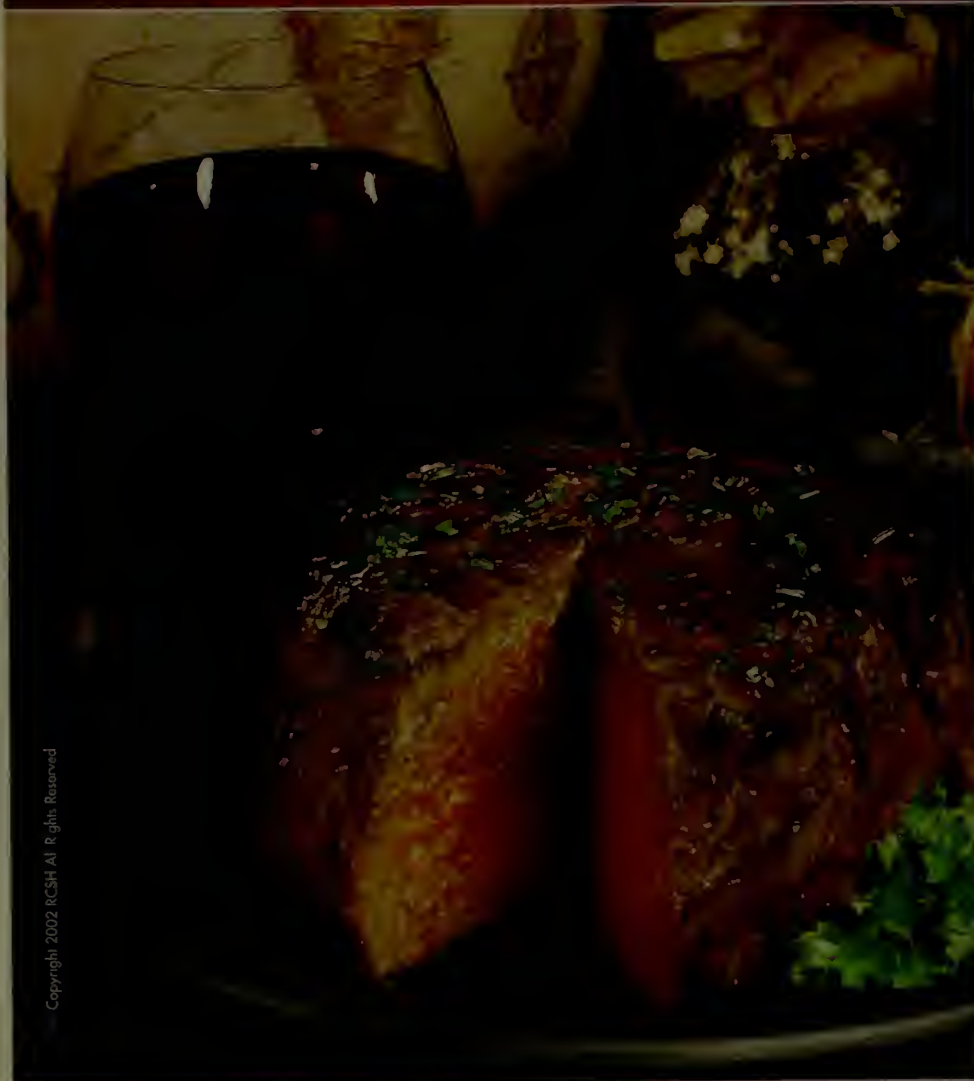
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People

sometimes a strained one at the love my father," he says. "Take a through my house, and it looks like the museum. Every picture on the wall is of my father, or me and my father to the point where my mom comes and says, 'Where are all my pictures?' But he has been extremely tough on me. Maybe you can call it tough love."

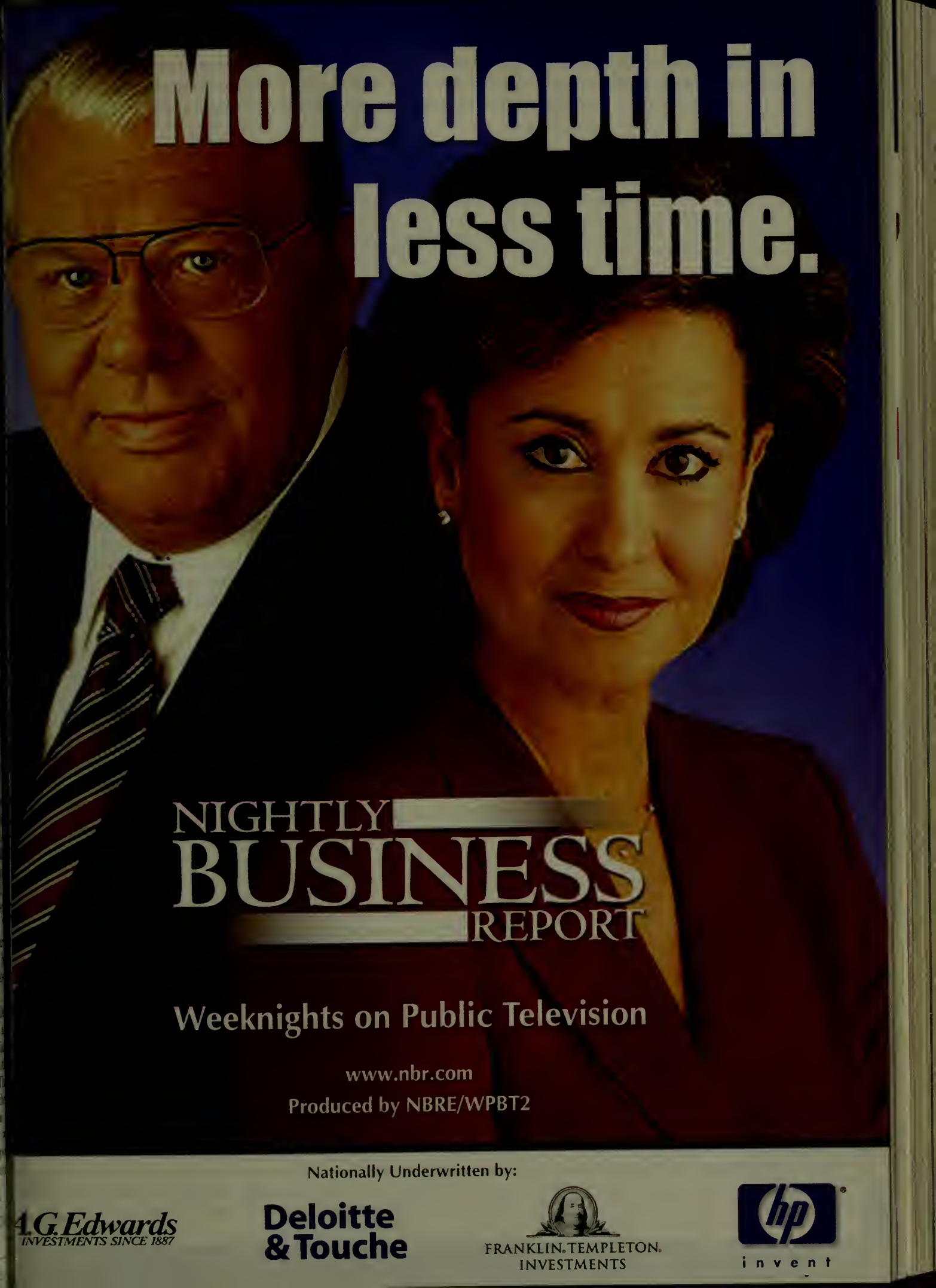
Early in his long tenure at A-B, Busch IV was abruptly rotated through a series of jobs in the brewing and packaging operations, from doing grunt work on the lines to participating in a labor negotiation. Once he was put on the marketing track in the late 1980s, his inevitable promotions were greeted warmly by A-B's independent wholesalers, many of whom believed he behaved wildly after hours and operated on his depth on the job. As he has demonstrated his knack for marketing, many of those doubts have been dispelled.

Busch seemed to come into his own at the company in the mid-1990s, a time when it was losing young drinkers to Coors Light, craft beers and imports. The Fourth's response was to push Budweiser advertising in a new direction, one closer to the creative approach that had long characterized Bud Light ads. For a brand that had been portrayed in ringing, anthemic terms as a reward for a hard day's work, it first seemed risky, even reckless. But over the years, the various campaigns were able to slow Budweiser's years-long slump and helped Budweiser to grab the lion's share of the booming light-beer sector.

Busch IV will admit, however, that his fondness for the night life helped him stay in touch with the sensibilities of young men who, after all, are the biggest consumers of his company's brews. "I think I have benefited from my lifestyle of being able to be very active in the marketplace," he says. "It has allowed me to understand our customer better and hopefully do a better job of creating products and images that are attractive to that customer."

Still, Busch IV will have to demonstrate that he has more than just a good eye for appealing beer commercials. He could find that his younger brother, crowned the next king of suds. "The boys bought themselves five years to develop August IV and Steven, and see what happens," says one longtime A-B watcher. As long as the brewer keeps pouring forth lush profits, shareholders seem content to let the kings reign.

By Gerry Khermouch and John Forster in St. Louis, with John Cadogan in New York

A man with glasses and a woman are shown from the chest up, wearing business suits. The man is on the left, and the woman is on the right. They are both looking towards the camera with slight smiles. The background is a solid dark blue.

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This is part of the Heidrick & Struggles' Leadership Capital series on the topics of governance and leadership. Subsequent articles will focus on the specific skills and challenges for other senior-level management roles and on the critical issues facing corporate leaders today.

FOCUS ON:

THE CHIEF FINANCIAL OFFICER



Barry Bregman

Managing Partner, CFO Practice

Heidrick & Struggles

If you ever took an interest in ancient Roman art and artifacts, or if you ever took high-school Latin, you may recall a deity named Janus. His special talent: he can see in opposite directions simultaneously, in one glance taking in past and future, global and local, inside and out. Today's corporate chief financial officer needs much the same range of vision.

The CFO position demands, as it always has, a high degree of technical competence in financial control and reporting. But the current environment, with its intense focus on corporate governance and transparency of information, also calls for a CFO who is an exceptional communicator. Of all the skills required in a top CFO, none is more valuable than the ability to build confidence and trust. It is as important among internal constituencies, including the CEO and the board of directors, as it is with crucial external constituencies, especially regulators, banking institutions, investors, and the media. Indeed, the CFO, along with the CEO, is increasingly the public face of the corporation. In coming years, we believe, demand will continue to grow for CFOs who can step up to a prominent leadership role and show the face of business at its best – successful, yes, but also honest, ethical, and straightforward.

Through our experience of conducting hundreds of CFO searches a year worldwide, we have witnessed a steady evolution and expansion of the CFO job. No longer merely a staff function, narrowly focused on the mechanics of finance, the CFO position now encompasses many different corporate activities and thus calls for an equally wide range of competencies. The CFO is intimately involved in treasury operations and tax planning, financial controls and regulatory reporting, strategic planning and risk management, organizational design and corporate communication. Above all, the CFO is one of the CEO's strategic partners – not just "running" the numbers but also providing valuable counsel on running the business.

My two guest commentators for this article have done more than witness the development of the modern CFO, they are helping to make it happen. Dow Chemical CFO Pedro Reinhard has more than 30 years of experience as a senior financial executive and is a leading practical authority on corporate governance. He sits on the board of Royal Bank of Canada, which was recently recognized by *Canadian Business* magazine as Canada's best board. In his current role, Reinhard is the executive responsible for the complex finances of a chemical and plastics company that serves customers in more than 170 countries and has nearly \$30 billion in annual revenues. Michele Burns has been CFO of Delta Air Lines for just two years, but undoubtedly, during

the most tumultuous period of the company's history. Over the past year, she has worked closely with Delta's executive leadership team to develop and lobby for legislation to provide fuel and loan guarantees to the airline industry and to develop an airline security plan for the United States. If any two people know what it takes for a CFO to be the CEO's strategic business partner, Reinhard and Burns do.

The top finance executive's role has been expanding steadily for decades, Reinhard points out. "The CFO job used to be transaction-intensive," he says. "Now it's knowledge-intensive. When I started out, the typical CFO spent most of his or her time on recording and reporting. Now the CFO is expected to contribute to a strategic assessment of the company and developing corporate strategies – and sometimes to leading those strategic efforts."

The CFO's sphere of responsibilities has grown so large that it touches nearly every facet of corporate activity. Burns maintains, "Creating, enabling, and controlling corporate infrastructure have thrust the CFO to the corporate frontline. Whether these role expansions be in strategic risk management or driving the IT advancements to achieve productivity gains, the CFO is at the forefront of each pendulum swing in business."

Therefore, it is essential for the CFO to have a close working partnership with the CEO and the rest of the senior leadership team as well as with the board. In fact, one of the most challenging elements of this very demanding job is the work of developing and maintaining lines of communication with various internal and external constituencies. With corporate information of all kinds, but especially financial information, subject to unprecedented levels of scrutiny, an organization can differentiate itself with a CFO who can communicate clearly, forcefully and above all, credibly.

EXPERIENCE MATTERS

In financial reporting, nothing enhances credibility more than experience in the field. Most CFOs whose career paths include stints at audit firms or in the finance departments of top corporations have an assurance and confidence that just can't be faked. Burns believes, "A CFO's familiarity with the nuts and bolts of financial reporting supplements their interaction within the organization, especially with the CEO, the senior leadership team and with board members. Just as important, it sends a powerful message to nervous markets." Hurt by their embrace of everything new, untested, and untried, investors are once again seeking out the voice of experience.

Of course, it's not just investors who appreciate the value of experience. More and more CFOs are coming to the post from operational assignments – in fact, some of the most prominent large-company CFOs are former CEOs of small or midsize companies. Coupling a sound foundation of financial mechanics with practical expertise, these executives have established finance as a key role in the strategic process, linking business, financial, human resources, and information systems strategies into a comprehensive whole.

Team building is one of the most valuable skills that operating experience can teach financial executives. CEOs and boards are looking for CFOs who can assemble strong teams to produce financial reports, conduct internal audits, run tax and treasury operations, oversee pension and venture capital investments, handle mergers and acquisitions, and manage relations with creditors and shareholders. In particular, companies will be competing to field best-in-class financial reporting and compliance teams, and they will look for CFOs to lead the effort. CFOs also have a responsibility to attract and develop a line of leadership succession within their group. Shaping a culture of excellence, integrity, and accountability, articulating a vision and focusing the team's energy – these are all vital components of a CFO's skill set, as vital as technical proficiency.

There's another team that claims much of the time and attention of today's CFO: the senior leadership team. Organizations have grown so complex, the business environment so competitive, that corporate management has become, of necessity, a matter of networks. Recognizing that collaboration isn't just a good idea, it's the only way to tackle the challenges confronting business, a growing number of senior corporate leadership teams are meeting monthly or even more often for intensive strategy reviews.

"At Dow," says Reinhard, "we spend a week together every month on the various issues we have to deal with, whether it's margin compression in our mainstay chemical business or integrating our acquisition of Union Carbide. As much as anything, it's a chance to share tacit knowledge – what works, what doesn't. That cross-fertilization is what you get from a network, a boundaryless team if you will, that you can't get from a strict hierarchy."

Muins contends, "In times of crisis, the seamlessness of the leadership team

is critical. The CFO's capability to quickly grasp and communicate the short- and long-term financial ramifications of decisions is paramount."

Corporate boards can be management's most valuable resource in turbulent times, and CFOs should be prepared to work intensively with directors. The days of the once-a-quarter call from the head of the audit committee are over. With renewed energy for their fiduciary duties, directors are taking an active interest in details of strategy, compensation, and financial reporting. As such, many CFOs are now speaking with the head of their audit committee on a frequent basis. Once again, the work of managing the relationship with the board calls for top-notch communication skills and the ability to foster collaboration. The best CFOs embrace the opportunity to interact with board members. They welcome the increased scrutiny as an opportunity to improve corporate performance and enhance the long-term value of the enterprise.

CONTINUALLY ADDING VALUE

Constructive engagement with the board is just one way CFOs fulfill their overriding mission, which is to increase long-term shareholder value. "As CFO," says Reinhard, "you're always looking at the interplay between the company and the financial markets and seeking opportunities to add long-term value." And there are always opportunities, he says, either through productivity enhancement or a more proactive approach toward risk management, or improved allocation of capital, or better decision support. "It's the CFO's job to add value," he points out, "even in adverse environments."

The next few years promise to be especially active on the finance front, as business reacts to a tide of new legislation and regulation written in the wake of the recent corporate governance scandals. Dow Chemical and Delta already have in

place most of the governance measures and practices mandated by the Sarbanes-Oxley Act. Dow has gone even further: The Financial Executives Institute developed and recommended a code of conduct and Dow has implemented it throughout its organization. "We're trying to set an example for other corporations," says Reinhard, as many companies are mobilizing to increase the number of outside directors on their boards, strengthen their audit and compensation committees, and overhaul their financial reporting mechanisms. Many organizations will designate governance reform as a major strategic initiative, and CFOs will be at the center of the effort, often as de facto chief governance officers.

Over the next few years, even the best-run organizations will have to contend with numerous attempts at legal and regulatory corporate reform. By working to make the process collaborative, CFOs can help government produce genuine reform rather than rules that stifle innovation or otherwise burden business.

By now it should be plain that the job of CFO is not for the easily discouraged or fatigued. It is a high-capacity position that calls on a wide range of skills and competencies. Not so long ago, many CFOs were basking in the glow of ever-increasing stock prices and ever-improving earnings. More than a few forgot that old proverb: "Never confuse brains with a bull market." But today, the job of CFO doesn't look easy or glamorous. Nor should it. The CFO of any corporation holds one of the toughest jobs in business, and it's getting tougher. At the same time, though, the CFO is continually moving closer to the strategic center of the corporation. The organization of the future is taking shape today, and as a strategic partner of the CEO, the CFO is a key collaborator in the transformation.

Heidrick & Struggles International, Inc. (Nasdaq: HSII) is the world's premier provider of executive search and leadership services consulting, operating from principal cities primarily in North America, Europe, Latin America, and Asia Pacific. Its core business, Heidrick & Struggles Executive Search, has been an industry leader for nearly 50 years, specializing in senior-level management assignments for a broad spectrum of clients representing every industry. The company has expanded its range of complementary leadership services to include the recruitment of emerging talent, executive assessment, interim executive placement, and professional development services such as coaching and executive education.

Barry Bregman is Managing Partner of the firm's CFO Practice and a member of its Global Financial Services Practice. His experience encompasses CFO and other C-level search assignments for a wide range of financial institutions and Fortune 250 companies.

For more information, email Barry at BBregman@Heidrick.com or the firm at CEO@Heidrick.com.

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EDITED BY OTIS PORT

WAKING UP A SLEEPING ANTICANCER GENE

WHEN CELLS TURN MALIGNANT, the immune system can often spot and kill them before they grow into tumors. But this sentinel system fails far too often. Geneticist and immunologist Wilfred A. Jefferies at the University of British Columbia wanted to know why. Searching for genes that are turned on and off in cancer cells, he discovered that a crucial gene is silenced in more than half of tumors—and in virtually all metastatic cancers. Its role: making a protein, dubbed TAP, that performs a key step in moving characteristic markers called antigens to the surfaces of cells. Without TAP, there are no cancer markers, so the immune system fails to spot the rogue cells.

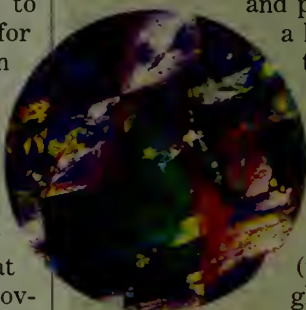
If he added an active version of the gene to tumor cells, Jefferies wondered, would the immune system then attack the cancer? His experiments in mice show that the answer is yes. When he used a modified virus to carry the TAP gene into mice with extensive small-cell lung tumors, 30% of the mice were cured. The rest showed no metastasis and lived twice as long as those without the gene.

Before Jefferies can try this approach in humans, the Food & Drug Administration wants proof it is safe to insert the gene. Jefferies, now chief science officer of startup GeneMax Corp. in Blaine, Wash., believes the company should be able to answer the safety questions and start clinical trials in melanoma patients within 18 months. In a forthcoming paper, he will also present data showing that adding the TAP protein can bolster the immune response to infectious agents such as HIV and smallpox.

John Carey

ONE WAY TO MAKE DRUGS IN A FLASH

MANUFACTURING DRUGS IS NO SNAP. BESIDES EXACTING requirements for purity and quality control, many chemical brews can take days or weeks to crystallize into a powder. Complicating matters further, as the crystals form, some molecules can assemble into two or more arrangements—and each of these so-called polymorphs can have dramatically different pharmaceutical and biological properties. The amino acid glycine, for example, has three polymorphic variations.



GLYCINE CRYSTAL

Soon, producing the desired polymorph of glycine, and perhaps of other amino acids, could get a lot easier. Chemical engineers at Polytechnic University in Brooklyn, N. Y., and Chicago's Illinois Institute of Technology have discovered that a flash of polarized laser light will instantly transform liquid glycine into one of two crystalline morphs, depending on how the light is polarized (the third version forms when the glycine isn't zapped with a laser).

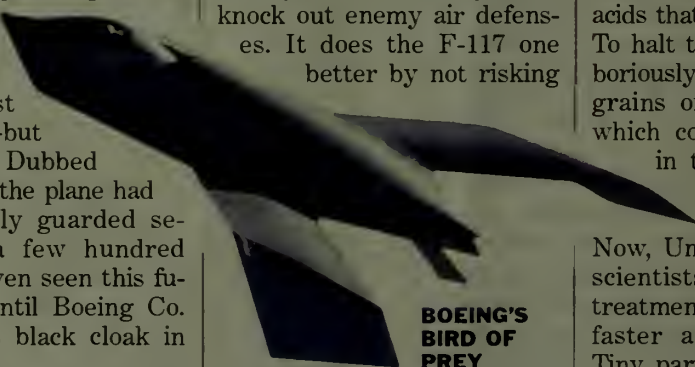
Bruce A. Garetz at Polytechnic and Allan S. Myerson in Illinois accidentally stumbled on the ability of lasers to induce rapid crystallization six years ago while studying urea, an industrial chemical. The recent discovery that the technique has pharmaceutical applications could have a big payoff. Already, the pair is branching into protein crystallization, which ordinarily can take months. ■

THIS BIRD HATCHED A ROBOTIC JET BOMBER

IF THE GULL-WING PLANE pictured here bears more than a passing resemblance to Klingon spaceships from the *Star Trek* TV series, that's probably just coincidence—but who knows? Dubbed Bird of Prey, the plane had been a tightly guarded secret. Only a few hundred people had even seen this futuristic jet until Boeing Co. pulled off its black cloak in mid-October.

While the stealthy aircraft will no longer take to the sky over the Air Force's hush-hush test range in Nevada—it has been retired—the 38 flights it made there since 1996 provided Boeing with a

wealth of new technology. The radar-evading shape of its fuselage and jet intake, for example, were refined for Boeing's X-45 unmanned combat-air vehicle, which recently made its maiden flight. The X-45 UCAV is a prototype robotic jet bomber designed to knock out enemy air defenses. It does the F-117 one better by not risking



BOEING'S BIRD OF PREY

pilots' lives. Boeing picked up the entire \$67 million tab for the Bird of Prey program and hopes to parlay that eventually into a juicy production contract for UCAVs.

Stanley Holmes

INNOVATIONS



NOSE JOB: New competitive

■ Because explosives can be wrapped tightly enough to elude today's mechanical sniffers, there is no perfect placement for dogs trained to sniff out bombs. So minute amounts of vapor almost always escape—and a dog can pick up their scent so can the gadget developed by researcher Duncan Graham at the University of Strathclyde in Glasgow, Scotland. A low-cost analytical technique—with the fancy name of surface-enhanced resonance Raman scatter (SERRS)—can detect faint whiffs of plastic-explosive vapors if the instrument treats incoming vapors with a mixture of sodium and mercury.

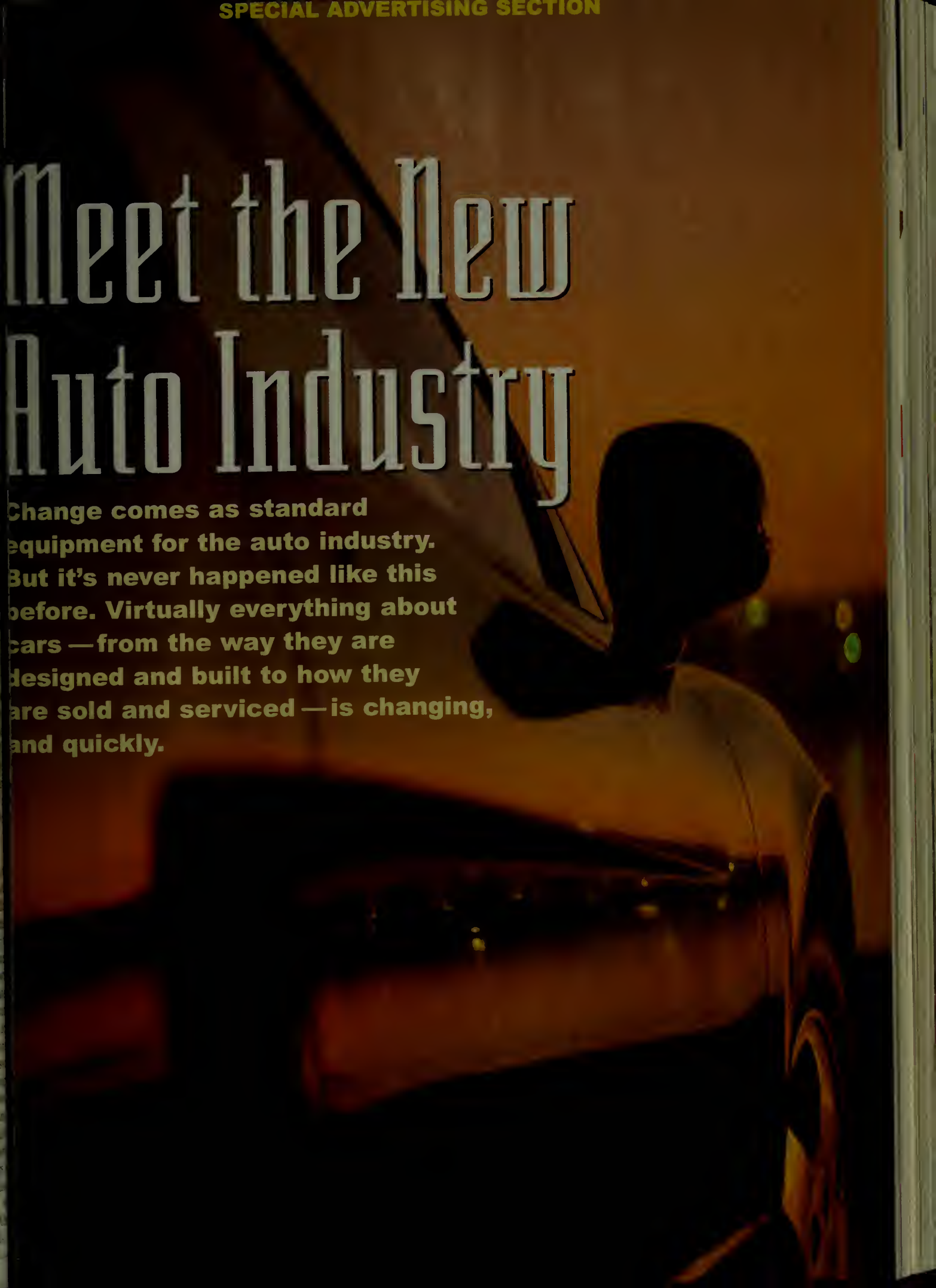
■ Around the world, books and documents are crumbling because paper made with wood contains acids that eat away the fibers. To halt the rot, librarians notoriously sprinkle paper with grains of magnesium oxide, which combines with water

in the air to create an alkali that neutralizes the acids.

Now, University of Florence scientists have devised a treatment that they claim is faster and more effective. Tiny particles of calcium hydroxide are dissolved in propanol alcohol and sprayed on the paper. The fibers soak up the particles, forming an internal reservoir of alkali that keeps on fighting the effects of wood-pulp acids.

Meet the New Auto Industry

Change comes as standard equipment for the auto industry. But it's never happened like this before. Virtually everything about cars — from the way they are designed and built to how they are sold and serviced — is changing, and quickly.



The hardest thing about winning so many races is getting that champagne smell out of our drivers' suits. Having won an unbelievable 10 of 11 GTS-class races this year, the Corvette racing team has had its fair share of the bubbly spilled on them. Highlighted victories include the 12 Hours of Sebring, the 24 Hours of Le Mans, and the season finale Petit Le Mans. In a true season of dominance, Corvette brought home the American Le Mans Series Manufacturer's and Team titles, while Ron Fellows secured the Driver's championship. Indeed, wherever there's a winner circle, we'll be there. corvette.com



INTRODUCTION

it the reinvention of the auto industry. By the end of this decade, cars and trucks won't just look different. They'll behave differently too, and they'll come from an industry that has overhauled virtually every facet of its business.

Our cars will still have four wheels, of course. And, for the most part, they'll still be fueled by gasoline and powered with piston engines. But myriad changes are afoot that are retooling the way car companies develop cars, what features they put in, and how they connect with their customers.

The effect will be to turn traditional auto-making upside-down. Increasingly, consumers will tell automakers what to make instead of settling for whatever the car companies decide to produce.

It's a fundamental realignment of the 100-year-old auto industry. And it's coming none too soon, say the experts.

One of them is David Cole, president of the Center for Automotive Research in Ann Arbor, Mich. Cole, considered one of the U.S. auto industry's most respected observers, is prone to hyperbole. That's what makes his assessment so startling.

"The industry's business model is broken in every respect," he declares. "The industry is doing how it does business, and the transition rate is very high."

Cole says the metamorphosis is being driven by competitive pressure, global overcapacity, new technologies, and the advent of Web-based collaborative tools.

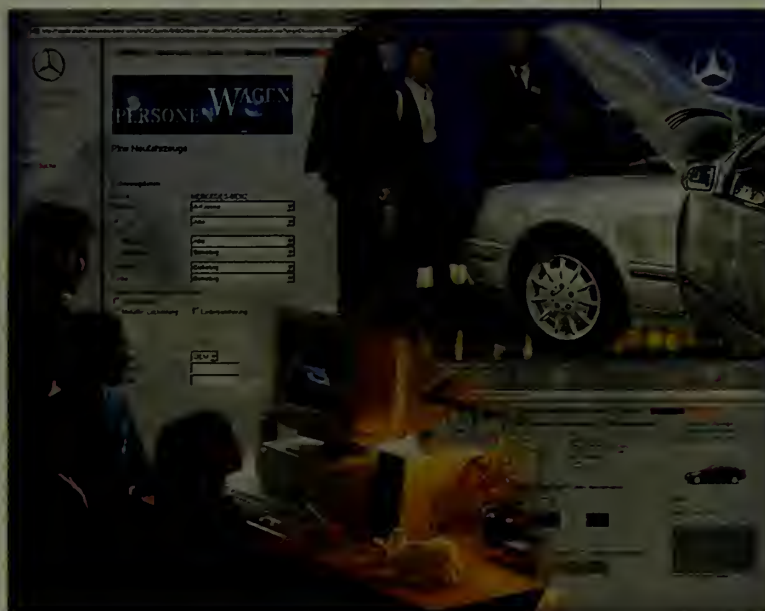
But they go much further than that.

Automakers are intent upon improving the "ownership experience" from purchase to trade-in and beyond. It's no wonder. On average, nearly half of a carmaker's customers defect to another company when they buy their next vehicle, according to research by R.L. Polk & Co., the industry's oldest statistical service. Polk says defection rates rise for individual car lines — Chevrolet or Mercury, for example — and go higher still for specific models.

The car companies have always known it's more cost-effective to keep a customer than win a new one. But now they're gaining the tools to do something about it.

Consider manufacturing. Suppose the car companies knew for certain what vehicles

The Internet is playing a fast-growing role in linking potential car buyers to automakers.



Increasingly, consumers will tell automakers what to make instead of settling for whatever the car companies decide to produce.

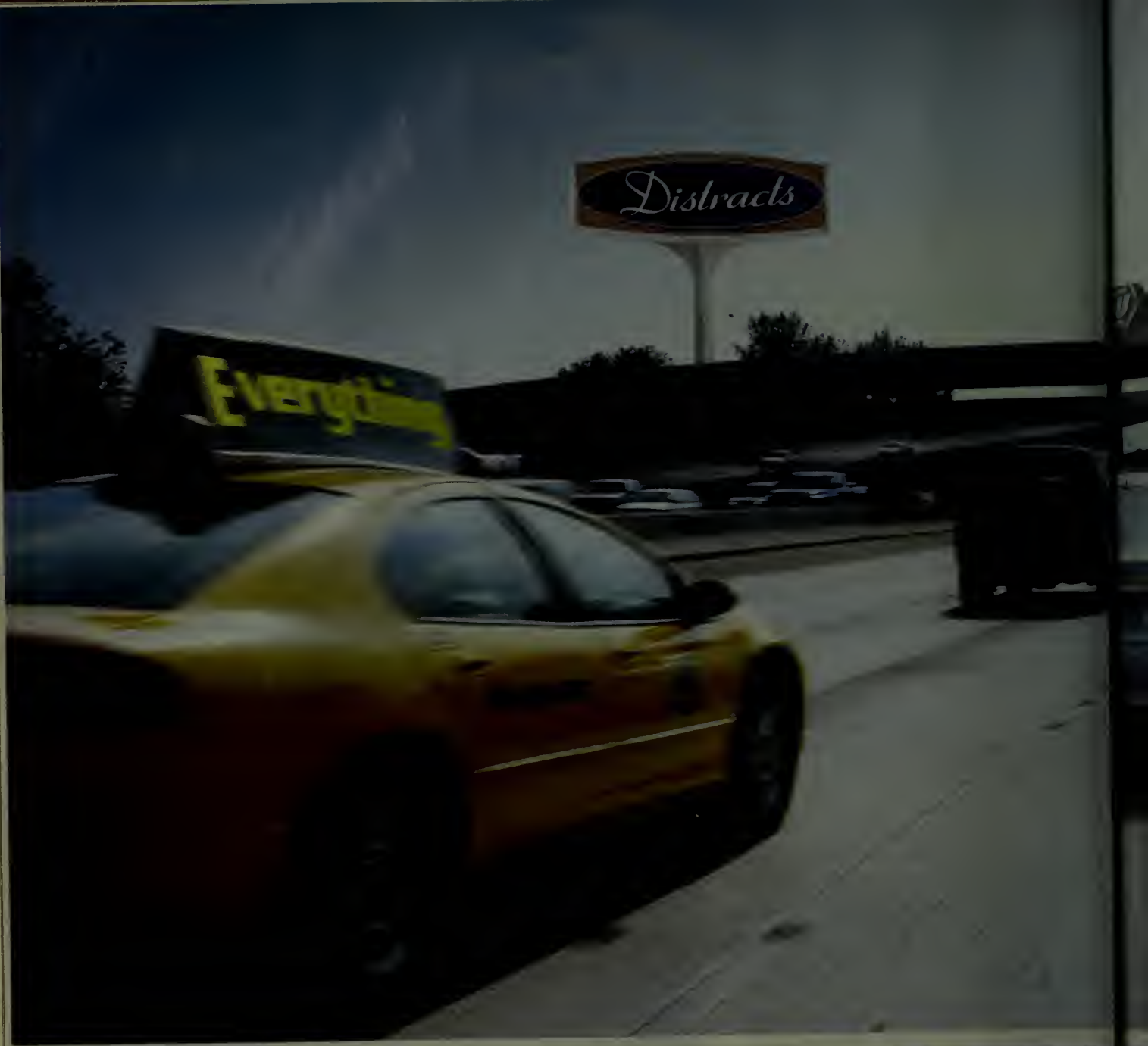
It's an unusually turbulent period," he says, "and it's going to stay that way for a more years. We'll know the industry has moved at a viable structure when there's appropriate profitability throughout the entire chain of suppliers and carmakers. We're nowhere close to it right now."

Retooling the Business Model

The changes Cole is talking about include the fundamentals of designing and making cars.

to make, who would buy them, and when. Imagine that their factories and the companies that supply them were so efficiently networked that they could react instantly to each new vehicle order.

In such a world, car companies wouldn't just make thousands of cars and hope people will buy them. They would know when each customer was ready to buy and what they wanted. They could deliver vehicles to order in a few days. And they would continue to monitor what you like and don't like about your car or truck for as long as you own it, using the



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en if you're not.

DAIMLERCHRYSLER

Answers for questions to come.

Ford Motor Co.'s new design center in London attempts to integrate future vehicle design with input from such non-automotive products as furniture, watches and guitars.

information to improve the next new model.

This vastly more efficient approach to personal transportation could trim up to \$1,000 in cost per vehicle now baked into the auto industry, estimates Lee Sage, vice president and general manager of Trilogy Inc., an Austin, Tex.-based provider of software that helps companies link and manage their systems.

"It won't be an overnight thing," Sage says, "but when you look out three or four years, our world will be a very different place."

CUSTOM-MADE

Mass-producing cars is an approximate science at best. Automakers try hard to guess what colors and combinations of features people will want. But once they crank up their factories, it's difficult to fine-tune the output quickly or tailor it to individual requests.

expectations. The two trends make it increasingly difficult for full-line car companies to keep track of such things as the thousands of combinations of models, features, options they could build.

Keep It Cheap

Complexity is challenge enough for today's auto industry. Now add the extraordinary market pressure created by better-informed consumers who want more performance and features for their dollar. The result, say industry gurus like David Cole, is a recipe for radical change to the automotive status quo.

"The pace of structural change is almost overwhelming," says Cole. "The industry is cutting costs and passing those reductions along to the consumer. Competition is allowing them to keep a reasonable pace on that saving."

General Motors Corp. figures net price of new vehicles have been going down since 1996 because modest price hikes are being more than offset by hefty rebates and other sales incentives — a trend that many analysts think is becoming an integral part of the automotive scene.

"We don't think the competitive incentive landscape's going to change anytime soon," notes Gary Cowger, president of GM North America. These days, he says of the companies, "Everybody is out there with gloves off."

How to cover the cost of building better cars at lower prices? For now, car makers are resorting to a familiar ploy that brings faster results to the bottom line: squeeze suppliers for lower prices. Many suppliers



Vehicles are being updated or replaced at a faster clip to keep up with accelerating customer expectations.

So car companies do the next best thing: They spend billions of dollars on sales incentives that help mold consumer demand to fit the available supply.

It's been that way for decades, but the system isn't working very well today. For one thing, the volume of vehicles automakers sell is spread over many more models, which adds complexity. At the same time, vehicles are being updated or replaced at a faster clip to keep up with accelerating customer

responding by adopting "lean" operating techniques embodied in the Toyota Manufacturing System, which emphasizes a relentless effort to eliminate non-value-added activities.

The Network Solution

But simply demanding lower and lower prices from suppliers won't work for long, observer David Cole points out. To rebalance the carmaking system, automakers and their suppliers are trying to network together.

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RANGE ROVER

General Motors Corp.'s "View-Master" system uses virtual imaging to show off its new products to potential customers.

activities far more closely than ever before.

The idea is to coordinate the flow of automotive parts and components much more closely, thus reducing inventories. The method — known in the auto industry as managing the supply chain — also makes it easier to spot and fix defects, improve quality, get newly designed vehicles to market faster, and respond more quickly to the ebb and flow of market demand.

It's not just an activity led by automakers. ArvinMeritor Inc., for one, has set up a global Web-based system that tracks the performance of its own suppliers worldwide in such



Input from the Consumer

Streamlining the way cars are made is certainly useful. But what about connecting the end of the industry with the customer side of the business? Linking the two would turn making into a truly customer-driven activity and give car companies and their suppliers a powerful new way to retool the old system.

Only about 10% of the world's manufacturers of any type link customer relations to production now, according to a recent study by Deloitte Research. Yet, it says, those that have been able to connect supply and production with the customer relations end of businesses generate up to 70% greater profit than those who don't. Deloitte says truly connected companies build customer loyalty and stronger repeat business, a challenge it describes as the next frontier in competition.

WHAT DO CONSUMERS WANT

The main reason auto production doesn't exactly match consumer demand now is that automakers don't know exactly what customers want.

Certainly they have a good idea about the wants of the overall market. And they would not remain in business very long if they failed to make products that appeal to consumers at least most of the time.

But carmaking has always been a game

Truly connected companies build customer loyalty and stronger repeat business, a challenge it describes as the next frontier in competition.

terms as on-time delivery, complaint rates and quality. The Troy, Mich.-based supplier says it will use the system to trim the number of suppliers it uses to a mere 1,000.

Managing the supply base gets tricky at lower levels, experts point out.

"Developing a sub-tier infrastructure means dealing with suppliers who are just as concerned about, say, Whirlpool as they are Ford," explains Brian Cunningham, director of Deloitte & Touche's Collaborate Supply Chain practice in Detroit. "They're responding to diverse industries with different agendas."

averages. Automakers conduct business appealing to large groups with common tastes, not individuals. They might know people like you love sport utility vehicles, but they aren't as confident about when you in particular might buy an SUV — or what would persuade you to buy one model over another.

Sharpening that focus is a huge part of the auto industry's renaissance. The goal is to zero in on consumers who are truly ready to buy, then cinch the sale with offers that are tailored to individual wants. Maybe price everything to your neighbor, even if it means



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waiting six weeks and driving to a dealer 100 miles away. But for you, paying a few hundred dollars more is worth it if you can get that new car delivered to your door tomorrow.

Car companies can't easily detect such differences today. But they're getting closer. Trilogy's Lee Sage says new software tools

them to be built. Not so here, where about of Americans shop for new cars and truck browsing through dealer inventories.

No one expects automakers in the U.S. or anywhere else to switch entire a build-to-order system anytime soon. Experts say the practice will pop up first

All the major car companies are taking steps to implement build-to-order strategies.



GM's Hy-Wire concept car with "plug-in" body and all-electronic controls is one of the industry's most radical ideas about the future.



enable some automakers to determine with about 80% accuracy which visitors to their vehicle Web sites are ready to buy and which are just kicking the tires.

The next step will be to link such information to product design and manufacturing. Analysts envision a future where automakers weigh your potential value to them — perhaps by looking at your purchasing history with their brands — and customize their interactions with you accordingly. Thus they might offer a take-it-or-leave-it discount for price-conscious comparison shoppers but provide special services for a repeat customer.

The Overnight Car

European car buyers are accustomed to ordering their vehicles and waiting weeks for

luxury cars and small-volume niche vehicles. But all the major car companies are taking steps to implement build-to-order strategies.

DaimlerChrysler AG's Chrysler Group offers a good example of what car companies are doing. By 2005, Chrysler expects to use computer simulation tools to plan and build every new production factory before it actually retools or renovates the facility. The goal, says Sue Unger, senior vice president and chief information officer, is "an end-to-end solution flowing from design and development to product planning and production."

Unger says Chrysler's system, developed with IBM and i2 Technologies, will shorten production planning cycles by up to 40%, boost quality, ensure each new operation uses "best practices," and cut costs. Chrysler has given some 4,000 engineering employees worldwide access to current engineering data through a Web-based portal it calls eEngineering. It plans to plug suppliers into the system by year-end.

Similarly, Chrysler is networking its 5,000 North American dealers through a single company system, DealerCONNECT, that standardizes more than 150 types of transactions between the company and its dealers. The system lets dealers worldwide order vehicles, parts, and check inventories online.

CALLING ALL CARS!

Tomorrow's cars will be safer, more efficient and considerably smarter than today's most advanced vehicles. The primary reason is telematics, the collection of wireless technologies and services that allows a vehicle to communicate with the world around it. Telematics promises a wealth of handy services for motorists and an important channel to keep car companies and their customers better connected.

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Some telematics services, notably OnStar from General Motors Corp., are available now. They can remotely unlock your doors if you leave your keys inside, automatically alert emergency personnel when you have a serious accident, and provide driving instructions and other information when you ask for it.

Proponents such as ATX Technologies in Dallas say such services barely scratch the potential for telematics. Eventually, telematics-

ics-equipped car senses that your engine coolant level is low. Your car alerts you, not the direction you are traveling, and as you would like it to locate a dealer in the town who handles your model.

You agree, so it uses your cell phone to call the dealer's service department and a mechanic on the line to troubleshoot the problem. She says it looks like you may need a new radiator hose. Your car conf

Many studies say some sort of telematics systems will be aboard half the new vehicles sold in the United States four years from now



Telematics promises to link cars and the outside world in ways that provide drivers with a new menu of conveniences.

equipped cars will check traffic along your intended route and recommend alternatives to avoid tie-ups. They will help you shop by scouting store bargains, checking on the availability of something you want, and even guiding you to a parking spot at the mall.

The technology to do these things exists now. The challenge is to figure out how to offer them in ways that don't interfere with the task of driving safety.

Developers say that won't take long. Indeed, many studies say some sort of telematics systems will be aboard half the new vehicles sold in the United States four years from now. Projections say the U.S. telematics market will be worth at least \$3 billion, and perhaps more than twice that, by 2004.

Convenience and safety will be the biggest attractions of telematics for consumers. But the car companies are intrigued by something else. For them, telematics represents a powerful new way to retain customers.

How? Suppose you are midway through an interstate driving trip when your telemat-

ics-equipped car senses that your engine coolant level is low. Your car alerts you, not the direction you are traveling, and as you would like it to locate a dealer in the town who handles your model.

Telematics proponents figure automakers that can coddle customers with that level of convenience are bound to boost repeat sales. And the ability of telematics-equipped cars to report their own operating condition — with the owner's permission, of course — could give car companies a stunning new way to detect product problems faster.

PULLING IT ALL TOGETHER

How quickly will the auto industry transform itself? Experts like David Cole at the Center for Automotive Research say cost pressures are so strong that the fundamental restructuring should be completed within about two years.

Fine-tuning all the connections between manufacturing and marketing will take more time longer. But the industry's commitment to completing the overhaul of the way it does business appears unshakable.

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Bill Hampton, who has written about the auto industry for more than 31 years, publishes AutoBeat Daily, an insider newsletter about the activities of the global auto industry.

Graphic design by Andrea Stork: Design.



HARVEY ON THE LINE

With Disney breathing down his neck, Miramax' Weinstein needs a hit

How do Hollywood moguls settle a dispute? Over waffles, if they're DreamWorks SKG partner Jeffrey Katzenberg and Miramax Film Co. Co-Chairman Harvey Weinstein. In his case, both men wanted to open their respective Leonardo DiCaprio flicks on the same day, Dec. 25. Normally, you might hand this one for Weinstein, who's more aggressive and a whole lot bigger than Katzenberg. But surprisingly, during an early October breakfast in New York, Weinstein ceded Christmas Day to Katzenberg for *Catch Me If You Can*. Miramax' *Gangs of New York* will premiere on Dec. 20. "Harvey graciously acknowledged that we planted our flag on Dec. 25," says Katzenberg.

Losing the prime release date is just the latest problem for Miramax in the past year. The studio has put out fewer big hits than in prior years, its top marketing executives bolted, and it laid off 75 staffers earlier this year, the first major downsizing in Miramax's 22-year history. Now, it faces its riskiest holiday season ever, releasing four films into a crowded field of competition. In all, the studio will likely spend \$150 million to make and market the new films that are scheduled for release in the coming weeks. And the buzz for *Gangs of New York* is mostly bad, raising questions about whether DiCaprio has lost his magic. "It's karmic payback for Harvey," says one A-list director, referring to the brusque, ultracompetitive Mira-

max co-chairman.

CHRISTMAS WISHES:

Weinstein, Clooney, Benigni, Zeta-Jones, and DiCaprio

Complicating Miramax' Christmas prospects, *Gangs* will open during one of the busiest holiday seasons in recent years, with 22 major films jammed into a two-month period, according to box-office tracker Exhibitor Relations Co. Among the competitors for eyeballs will be the 20th James Bond film, *Die Another Day*, and sequels to *Star Trek* and *Harry Potter and the Sorcerer's Stone*, which last year grossed \$318 million (table, page 96). "It can be a killing field out there for some films," says independent film marketing consultant Peter Graves.

Weinstein's big bet on the holiday season is also giving a migraine to Michael D. Eisner, CEO of Miramax parent Walt Disney Co. Hollywood power brokers have been whispering for months that Eisner is steamed at Weinstein for allowing the costs of *Gangs* to go as high as an estimated \$120 million, making it Miramax' priciest project ever. (Miramax claims it cost only \$100 million.) Disney is already battling a lackluster economy at its theme parks and tepid ratings at its ABC television network.

How much of a problem Miramax will be for Disney is unclear. The parent has given Weinstein and his brother, Co-Chairman Bob, pretty much a free hand ever since Disney bought the studio for \$60 million in 1993. Disney doesn't break

out Miramax' numbers, but sources say the studio's operating profits—which Weinstein claims were \$140 million (and others dispute)—will be down for the fiscal year ended Sept. 30. Expect a further drop this year if Miramax suffers yuletide disappointment. A Disney executive denies that Eisner is upset with Miramax, noting that the revenue from the Miramax library "by far exceeds any year-to-year earnings comparisons."

Miramax executives insist they have insulated themselves from losses on *Gangs*. As they do on most films, the Weinsteins routinely bring in partners to share the costs. That's the case with the much-delayed *Gangs*, a violence-splattered 1800s piece directed by Martin Scorsese, who began filming the movie, also starring Cameron Diaz and Daniel Day-Lewis, without a completed script. Early on, Disney sold the foreign rights for \$65 million. DiCaprio and Scorsese paid a total of \$7 million to help fund overruns, but that still left Disney and Miramax to put up the rest. To market the film in the holiday crush, Disney and Miramax will need to spend \$30 million or more.

How Miramax will get its money out of *Gangs* is hard to fathom unless it's a big hit. Having sold off the foreign rights, Disney and Miramax won't see a dime from countries where DiCaprio and Day-Lewis are popular, especially in Europe. At 2 hours and 40 minutes, the number of nightly showings is limited. And with *Gangs* rated "R" for its violence, it's roped off from the teen viewers who can make films monster hits. Instead, teens will likely flock to the second installment of PG-13-rated *Lord of the Rings: The Two Towers*, that

opens two days earlier or Steven Spielberg's *Catch Me If You Can*. Miramax officials counter that polls show that awareness for *Gangs* is high and the "R" rating shouldn't make a difference. Factoring in video and DVD sales, claim Miramax executives, *Gangs* needs to take in \$60 million in the U.S. to break even.

Gangs of New York isn't Miramax' only holiday challenge. It's also releasing an English-dubbed version of *Pinocchio* starring Roberto Benigni, best known to U.S. audiences for Mi-

a *Dangerous Mind*, about game-show impresario Chuck Barris, who claim have been a Central Intelligence Agency hit man. Both movies will be released on a limited basis in December, before a broader January release.

A hot Christmas would help Miramax, whose 2002 so far hasn't matched last year's blowout, with blockbusters such as horror thriller *The Others* and the PG-rated action film *Spy Kids*. Miramax' 21 films so far this year have averaged \$10 million each at the box

office—half last year's average. It lost money on the Nicole Kidman thriller *Birthday* and will likely lose more on *Waking in Reno*, the just released Billy Thornton comedy. Even *Spy Kids* 2's million box office appointment after Miramax projected a \$8 million blockbuster.

Miramax didn't make Weinstein available for this article, but in earlier interviews he has said his business after being

distracted by the past year by investing in Broadway plays, such as *The Production* and stumps for Democratic pols such as Hillary Clinton. Still, Miramax

could end up with Disney's doghouse next year. Another loon budget-breaker is *Mountain*, based on Charles Frazier's Civil War best-seller. It's payday for stars such as Kidman, Renée Zellweger, and J

Law has nearly doubled the film's budget, to \$84 million, sending one partner Metro-Goldwyn-Mayer Inc. into bankruptcy and forcing Miramax to search for another partner. Miramax executives say they'll find the money. They'd be saying that if *Gangs of New York* bombs, Scorsese's mean 19th century struggle may not be the only bloody page around Miramax.

By Ronald Grover in Los Angeles



MOVIE (STUDIO)

HARRY POTTER AND THE CHAMBER OF SECRETS (Warner Bros.)

DIE ANOTHER DAY (MGM)



◀ **TREASURE PLANET** (Walt Disney)

STAR TREK: NEMESIS (Paramount)

THE LORD OF THE RINGS: THE TWO TOWERS (New Line)

CATCH ME IF YOU CAN (DreamWorks)

RELEASE DATE BUZZ

11/15 Harry, Ron, and Hermione are back, along with a flying car, but this isn't likely to be as big a hit as the first installment.

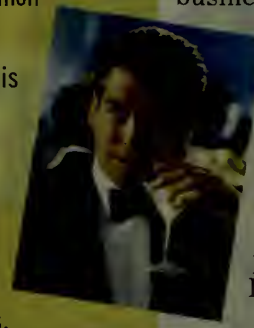
11/22 Pierce Brosnan, speeding cars, and Halle Berry in a bikini. The last three Bond flicks each did \$300 million worldwide. This could, too.

11/27 A flying pirate's ship? After this summer's hit *Lilo & Stitch*, it looks as if Disney's animation magic may be back.

12/13 A franchise that could use some warp power has turned up the phasers with an overdose of special effects.

12/18 The second of three installments produced for \$170 million last year, the Tolkien tale could again be the Christmas champ.

12/25 Spielberg and Hanks—and DiCaprio, too: Need we say more?



Data: Exhibitor Relations Co., BusinessWeek

ramax' 1999 smash *Life Is Beautiful*. *Pinocchio* opened strongly in Italy, where Miramax doesn't own the rights, but it isn't expected to do as well in the U.S. Miramax' two other holiday films are uncertain as well. The buzz is good for *Chicago*, the film version of the Bob Fosse stage musical starring Catherine Zeta-Jones and Richard Gere. But it's just about nonexistent for the George Clooney-directed *Confessions of*

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Few chief executives will talk about it. But more and more, they're turning to counselors for help in navigating the current corporate turmoil. Here's a look inside the inner sanctum

BY MICHELLE CONLIN

There was a time when executives under David S. Pottruck felt less like professionals at the helm of a major brokerage than cowering children held hostage by a despotic father. Lording over the conference room, the now co-CEO of Charles Schwab & Co. bulldozed other people's opinions and overruled their strategies. He reveled in teamwork—if he was the captain. Ideas were great, but only if they were his. Try challenging the former All-Ivy wrestling champ, and you could find yourself caught in a corporate full nelson—left with a lot of bruised feelings and a trampled ego. “I knew there was always a lot of glass being broken around me,” says Pottruck, a 6-ft.-1-in., 240-lb. rock pile of a man whose voice still carries traces of his native New York. “But I thought I was a great leader. I didn't understand that there was a problem.”

That is, until his nadir a decade ago, when his then-boss,

Chief Operating Officer Lawrence J. Stupski, took him into his

Management

office for an annual performance review. “Man,” Pottruck recalls Stupski saying, his normally even voice strained with anger, “you are high-maintenance—and you are painful.” The next part seared him even more: “Your peers don't like working with you—and they don't trust you.”

Thus began the restructuring of David Pottruck—his personality, his management approach, and his leadership style. Guiding him was an ex-IBM exec named Terry Pearce—the *éminence grise* of the growing niche of executive coaches whose specialty is in rewiring burned-out, bottomed-out, or simply ineffectual chief executives. Nothing was off limits—not even Pottruck's messy second divorce and his subsequent romantic involvement with a company employee (to whom he's now married).

Pearce flew with Pottruck on the company jet, ate room-service with him in posh hotels, and spent weekends at “Camp David,” Pottruck's former *hacienda*-style mansion where everything—the ceiling heights, the staircases, the flower arrangements—was “Dave-sized.” Once, Pearce took Pottruck to a “sweat” in the northern wilderness of Washington State, where they huddled in a steaming-hot lodge covered in pine boughs and listened to a shaman lead them in a spiritual cleansing. Afterward, they jumped into an ice-cold lake. For Pottruck, it was a kind of baptism into new behavior. “It's not comfortable to have someone constantly telling you how you can be better,” says Pottruck in an interview in his executive suite overlooking San Francisco Bay. “But it's very hard to get better on your own.”

CEOs, whose every misstep can be murder on their com-





COACHES

panies' stock, usually speak in corporate jargon lifted directly from the annual report. Get a moment alone with them, and they'll often purge their personal narratives of anything that doesn't show them off as shrewd or heroic. But Pottruck talks about his failed marriages (he was to blame, not his "wife selection" problem), his therapy, and his recovery from egomania. With Pearce's help, he has crafted a leadership style that centers on what he calls authenticity; that means he constantly communicates with employees about the company's wrenching restructuring and layoffs. He also tries to get across what he's like as a person, what he values (spotless ethics, emotional maturity), and his vision for Schwab as the anti-Wall Street brokerage. And rather than avoid the animosities, communication breakdowns, and jealous flare-ups on his team—as well as his own defects—he confronts them.

At a time when some CEOs are busy choosing defense lawyers, using a coach to rehab behavior may seem a low priority. But Pearce and Pottruck, among others, believe such help is key to developing a company culture in which CEOs encourage people to tell the truth and, as management expert and author James C. Collins puts it, "conduct autopsies without blame." Stockholders and employees alike, they argue,

should be glad of the self-aware, ever-improving CEO. He's likely to be the opposite of the Enronesque narcissist who perverts the rules in the name of profit worship and crushes anyone who dares criticize his moves.

During these months of corporate scandal, Pearce has been advising Pottruck all the more—in the back of chauffeured cars, on golf courses, in his walnut-paneled office. Pearce often lurks in the shadows at meetings—and then later picks apart Pottruck's performance. Pottruck also backs up his talk of integrity with action. While most of his cronies raked in an average of \$10 million last year, along with the personal Gulfstreams, company subsidized *pieds-à-terre* and golf club memberships, Pottruck took no bonus and a 93% pay cut—to \$603,000. "We overinvested during the boom. And the buck has to stop with me. I bear responsibility."

Although his candor may be unusual among the ruling elite, Pottruck is hardly alone in turning to an executive coach for help. The truth is that being a CEO—especially at a time when shareholders, regulators, and class-action lawyers are taking aim—can create demands that are impossible for one human being to handle alone. Every day, CEOs face blowups on their staffs and ethical dilemmas they feel ill-equipped to handle. The global economy has stretched the CEO skill set. Leaders can no longer be just stellar strategists. They also have to be masters of their emotions. Yet the talents that vault people to the top job are often those—dominating meetings, pushing through a project at all costs—that end up sabotaging them. Plenty of CEOs are interpersonal disasters. Ask board members, and they'll tell you: CEOs get hired for their skills but fired for their personalities.

That's one reason why some of the most powerful CEOs of some of the biggest global companies have been relying

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CIAMPA, WHO HAS ADVISED PFIZER'S MCKINNEL, SAYS CEOs FAIL WHEN "THEY MISREAD THE CULTURE"

so helpful that he sent his wife Karen to see him.

Coaches are distinct from management consultants, who specialize in the operational and strategic realm. The coach's arena is one of interpersonal relations, office politics, and corporate culture. Relying on their backgrounds in both business and psychology, they perform interventions on dysfunctional teams, confront bullies who hijack meetings, and counsel CEOs on wielding their power more effectively—teaching them to inspire and influence rather than command and control.

Sometimes, coaches interview a CEO's family and friends to draw a fuller personality portrait—or to crack open an executive's denial about his

more and more on these new high priests of corporate survival. During the boom, many companies hired scads of coaches—who often didn't have a clue about the firms' overall strategies—to work with managers. To be assigned a coach was to be seen as an up-and-comer. But coaching at the uppermost levels remains a hidden sanctum, with many CEOs availing themselves of the services in total secrecy. They fear that being seen as depending on a coach will

make them seem weak—or worse, incompetent. But lately, even boards of di-

rectors are insisting on them. Aside from Pottruck, eBay's Margaret Whitman, Pfizer's Henry McKinnell, Unilever Group Co-Chairmen Anthony Burgmans and Niall FitzGerald, and Belo's Robert Decherd have all worked with coaches. So has the senior leadership at American Express Co. In the upper reaches of Washington, Treasury Secretary Paul H. O'Neill hired a coach to help him transform the lumbering department into a more responsive branch of government. Former Bain & Co. CEO Tom Tierney found his coach

own behavior. One senior leader, on the verge of chiefdom at a top-tier financial-services company, couldn't believe that he was coming across as untrustworthy—until his coach read transcripts of interviews with his friends saying they thought he would "stab his own mother in the back." If deeper problems in the CEO's life are uncovered, companies sometimes provide marital counseling and child therapy to help the executive cope. "CEOs realize they need to be the world-class athletes of business," says Bain CEO John Donahoe. "And contrary to being a sign of weakness, it's now perceived as a strength if people are getting help and investing in themselves."

Now, as the era of the imperial CEO draws to a dramatic and painful close, CEOs are relying on these corporate *consiglieri* even more. "This is enforced reflection," says Annie McKee, who coached the Unilever co-chairmen on a cultural turnaround that kicked off in the jungles of Costa Rica. There, the entire senior team talked openly about themselves, each other, and the company's "unspeakables."

Management

McKee and the other members of the elite corps of CEO coaches make up a sort of cabal, their reputations built on

CORPORATE CONSIGLIERI

Some of the most powerful CEOs in Corporate America have turned to coaches such as these for help in the one area where they often fall short: the interpersonal.



NOEL TICHY

In the mid-1980s, he ran GE's Crotonville (N.Y.) management training center. Is still tight with Jack Welch and introduced him to

his friend Suzy Wetlaufer, the former editor of *Harvard Business Review*. Has worked with execs at Best Buy, Royal Dutch Shell, and Trilog Software.



DAN CIAMPA

Ex-CEO of consulting firm Rath & Strong and a leader in the field, Ciampa hates the term "coach," preferring to think of himself

as an advice giver. Works with Pfizer CEO Henry McKinnell and Treasury Secretary Paul O'Neill. But was also on board during Lloyd Ward's failed tenure as Maytag CEO.



JOHN THOMPSON

Heads consulting firm Human Factors in San Rafael, Calif. Works with eBay CEO Meg Whitman. Has dealt with some of Silicon

Valley's biggest ego clashes, including one at SGI between founder James Clark and CEO Ed McCracken. Takes troublesome clients "to the woodshed."



ANNIE MCKEE

Co-chair of Teleos Leadership Institute in Philadelphia, McKee coaches Unilever's co-chairmen and Merrill Lynch execs. Is

famous for her process of "dynamic inquiry," in which she probes until she finds out what's really going on in the company. Measures her "corporate investigations" with hard data.



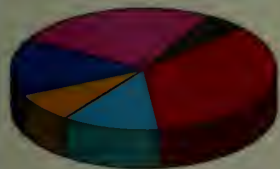
KATHRYN WILLIAMS

A partner at KRW International, a senior-exec development firm. Dives deep for her in-depth analysis. Coaches the top brass at

American Express. Often conducts sessions over fresh-brewed coffee in an apartment in New York's Battery Park City, near AmEx headquarters.

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THE MANY FACES OF THE DYSFUNCTIONAL CEO

Most CEOs didn't get their jobs by being great with people. But more and more, that's what the work is all about. Here's a look at some of the most common personality types that make a mess of corporate cultures.



NARCISSIST

Can't see how anyone else adds value. Insists on making all decisions. Plays it close to—if not over—the line. Only able to hire sycophants.



CEO DISEASE

Cuts himself off from the troops. Luxuriates in his perks. Loses touch with what's really going on.



CONFLICT-AVERSE

Avoids confrontation at all costs. Hides out from angry board members. Doesn't deal with conflict in front of the staff. Loses respect.



COMMAND AND CONTROL

The General Patton-style CEO. Issues directives and edicts. Never bothers to build consensus. Drives up turnover.



ALL IQ, NO EI

An interpersonal disaster who alienates those she needs most. Lacks emotional intelligence. Resentments fester; backstabbing ensues.

word-of-mouth in exclusive circles. Some rely on big doses of self-promotion and best-selling advice books. For the top names—such as KRW International founding partner Kathryn B. Williams, Dan Ciampa, and Jack Welch protégé Noel Tichy—companies are willing to pay from \$150,000 to as much as \$1 million a year.

Of course, there are plenty of hacks, as well as 1-800 numbers promising coaching skills in just hours and schools offering mail-order degrees. There's no industry regulation: Hairdressers require

more credentials. Worse, companies can be naive consumers, failing to conduct even basic background checks. Ford Motor Co. once hired a coach who had lost a sexual harassment suit.

Even coaches at the top of their field have had roles in some of the biggest corporate flameouts of the past quarter-century, including Tichy's Svengali-like influence over former Ford CEO Jacques A. Nasser in the late 1990s. Critics charged that Tichy beguiled Nasser into thinking he would be the next Jack Welch, including pushing him to implement a General Electric-style, rank-and-yank performance evaluation system that landed the company in court and cost it \$10.5 million to settle. Nasser is not talking, but Tichy counters that

the board didn't give the new revolution nearly enough time or support to succeed.

At Maytag Corp., Lloyd D. Ward alienated employees—with a coach at his side. Insiders complained of Ward's arrogance and failure to marshal internal support. And a Silicon Valley coach had a hand in making candidates for the CEO job at Hewlett-Packard Co. undergo a grilling by a panel of psychologists.

Carleton S. Fiorina won the job to transform HP's consensus-at-all-costs culture and pull off a drama-free turnaround. Instead, she wound up embroiled in one of the nastiest proxy battles in corporate history. Even the coach's warnings about the cultural "antibodies" that would attack her if she pushed through too much change too fast weren't enough to keep her out of trouble. Her predecessor, the arm-around-the-shoulder Lew Platt, was famous for tooling around in a Ford Taurus and taking smoking breaks with the janitors. Fiorina quickly earned a rap as a diva by buying private planes and hiring a posse of security guards.

But coaches have also had their fingerprints on some noteworthy turnarounds, such as those at Unilever and DTE Energy Co. When the work is successful, it's because coaches help fill in the information vacuum surrounding most CEOs. Even the highest-ranked executives can be afraid to tell the boss the truth. In fact, top execs get less feedback about their performance than anyone else. And studies show that the higher up the ladder they climb, the more likely senior execs and CEOs are to think their performance is much better than their underlings do.

As an organizational agnostic with no agenda, a coach can move up and down the ranks, sleuthing out the shadow culture—all the subtextual undercurrents driving the company that are never talked about. By interviewing senior team members and synthesizing themes without divulging confidences, coaches can provide the kind of unvarnished feedback that helps inoculate leaders against CEO disease. Says Ciampa, who has coached Pfizer CEO McKinnell, Treasury Secretary O'Neill, Corning Chairman James R. Houghton, and former Maytag CEO Ward: "When CEOs fail and most do...it's because they misread the culture and the politics. And in the process, they don't manage themselves or their emotions very well."

Can coaching actually fix all that? It depends upon the tal

Management

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PAYOFF *By using emotional-intelligence skills, coaches say, CEOs can improve the culture—and drive up profits*

ents of the coach as well as the ability of the CEO to change. The reigning alternative is the \$10 billion a year Corporate America lavishes on leadership training. Studies show that the benefits of this seminar-heavy schooling usually vanish within a few months. But research from Case Western Reserve University's Weatherhead School of Management shows that the impact of coaching-like training can last seven years. The emotional-intelligence skills coaches specialize in help CEOs create more productive cultures, which in turn drive up profits, according to Daniel Goleman, Annie

Management

McKee, and Richard Boyatzis in their recent book, *Primal Leadership*. Premier coaches—like good therapists or sponsors in 12-step programs—hold people accountable for sticking with new behavior. Says Goleman: "Without a coach, a lot of CEOs are likely to give up."

At eBay Inc., CEO Meg Whitman has worked with coach John Thompson, CEO of San Francisco consulting firm Human Factors Inc. The coaching has centered on succession issues, Whitman's vast wealth (including whether she should buy her own jet), and building the bench-strength of her executive team. Thompson has also helped her sort out conflicts among senior executives who aren't getting along. "It's like marriage counseling," he says, "or taking your son to the woodshed."

Thompson also has cracked some of Silicon Valley's toughest cases of clashing egos, including Silicon Graphics Inc. founder James H. Clark and its former CEO Edward R. McCracken, who fought so badly back in the early 1990s that Thompson could barely get them to speak to one another. At the time, Clark said he felt as if he knew what markets SGI should go after better than McCracken, and he thought McCracken unfairly hogged credit for SGI's success. McCracken, for his part, thought Clark wouldn't get out of his face. "Clark just couldn't let go," says Thompson.

John E. Lobb, former CEO of electric utility DTE Energy, knows the hanging-on-too-tight syndrome all too well. When deregulation hit in the early 1990s, Lobb realized he would have to turn his risk-averse utility into a tougher competitor. But Lobb, who was known by employees as "the Don," knocked down any maverick who came to him with a new idea. He relished asking employees unanswerable questions—a subconscious ploy, he later realized, to show he was in control.

Lobb finally caved to a senior executive's advice. He allowed coach Dean Anderson of Being First Inc. in Durango, Colo., to drag him and 20 top

execs to a lodge in woodsy northern Michigan. He thought Anderson was full of psychobabble—until Anderson had each of the team map out which people they had a good relationship with and which they didn't. Lobb realized there were so many breakdowns on the chart that it was a wonder the company was still in business.

Lobb was 54 years old. He felt calcified in his ways and wondered if he had it in him to change. Still, he agreed to let Anderson launch some new initiatives at Detroit Energy Company, including rewarding risk-takers and giving people the power to make their own decisions. "I had so many lapses, it was unbelievable," he says. One time, when he fell into his old interrogator routine, a senior executive snapped back: "You can't ask me that. I'm empowered!" Says Lobb: "I wanted to kill him. But I just had to bite my lip and move on."

Not that such corporate psychotherapy would suit every CEO. Ciampa, who wears crisp monogrammed shirts and walks with an imperial gait, sticks to the role of advice giver in the old-school style of Clark Clifford conferring with John F. Kennedy. He was a CEO himself—at consulting firm Rath & Strong. As such, he believes he offers an understanding of power and the incessant pressures on the person of last resort. He's famous for his exhaustive white papers, which he fires off to his clients on topics ranging from succession to culture fixes. Yet even the elegant Ciampa admits that, at bottom, "it always bleeds into the interpersonal.... My responsibility is to help them look inside themselves as much as outside."

Pfizer's McKinnell hardly seems as if he needs coaching. The admired leader runs a top-performing company. But he seeks out Ciampa for his brutally honest feedback and role as a seasoned sounding board. McKinnell is fanatical about seeking advice and fine-tuning his management. He has a "network" of coaches and demands constant input from his staff. To encourage unfettered openness, he posted his 360-degree performance review—flaws and all—on the company intranet. He grills employees even temps, about what's bothering them. "It's about being confident enough in your own abilities to be able to say to the leadership team you're working with 'Here's what I think the problem is, here's what some of the alternatives are, but I really don't know how to solve this problem.' And it's the 'I don't know' part that is absolutely essential." After an age of CEO arrogance, McKinnell may be on to something.

With Kathleen Kerwin in Detroit and bureau reports

AT FIRST, EX-CEO LOBBIA (LEFT) OF DTE ENERGY JUST THOUGHT COACH ANDERSON WAS FULL OF PSYCHOBABBLE



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HIP H&M

The Swedish retailer reinvents the world of affordable fashion

Stefan Persson, chairman of Swedish retailer Hennes & Mauritz, vividly remembers his company's first attempt at international expansion. It was 1976, the year H&M opened its London store in Oxford Circus. "I stood outside trying to lure in customers by handing out ABBA albums," he recalls with a wry laugh. Persson, son of the founder and then age 29, waited for the crowds. And waited. "I still have most of those albums," he says.

Don't cry over that vinyl, Stefan. ABBA is still hot, but H&M is even hotter. Hotter than Shakira in July. Hotter even than harem pants—incidentally, an item flying out of H&M's stores this season. (Warning to female shoppers: If you don't want to be a fashion pioneer, those pants may not be for you. Try the peasant blouse instead.)

A slowing global economy, lackluster consumer spending: There's little sign of either at H&M. While rivals retreat from disastrous foreign forays and retailers

across Europe and the U.S. struggle to post a profit, H&M's pretax income is set to hit \$833 million in 2002, a 34% increase from the previous year, on sales of \$5.8 billion, according to Keith Wills,

Goldman, Sachs & Co.'s European retail analyst. The growth is being fueled not only by expansion: Wills also estimates same-store sales will be up between 4% and 5% this year. H&M has \$1 billion in cash. Its market capitalization of \$15 billion outstrips that of Gap Inc. and Zara International, its closest competitors. And at current sales levels, the chain is the largest apparel retailer in Europe. Although the stock has bounced around this year, it has nearly doubled since 1997 and has far outperformed the Stockholm index. This isn't a store chain. This is a money machine.

If you stop by its Fifth Avenue location in New York or check out the flagship at the corner of Regerings-

CHEAP CHIC

It's exuberant, it's over the top—and it's working

gatan and Hamngatan in Stockholm, it's easy to see what's powering H&M's success. The prices are as low as the fashion is trendy, turning

each location into a temple of "cheap chic." At the Manhattan emporium mirrored disco balls hang from the ceiling, and banks of televisions broadcast videos of body-pierced, belly-baring pop princesses. On a cool afternoon in October, teenage girls in flared jeans and two-toned hair mill around the ground floor hoisting piles of velour hoodies, Indian-print blouses, and patchwork denim skirts—each \$30 or under. (The average price of an H&M item is just \$18.) This is not Gap's brand of classic casuals or the more grown-up Euro-chic of Zara. It's exuberant, it's over the top, and it's working. "Everything is really nice—and cheap," says Sabrina Farhi, 22, as she clutches a suede trench coat she has been eyeing for weeks.

H&M is also shrewdly tailoring its strategy to fit the U.S. market. In Europe H&M is more like a department store, selling a range of merchandise for men, women

teens, and children. Its U.S. stores are geared to younger, more fashion-conscious females. And while the pricing is cheap, the branding certainly isn't. H&M spends a hefty 4% of revenues on marketing. This year's photo ad campaign was shot by fashion-world legend Richard Avedon.

Behind this stylish image is a company so buttoned-down and frugal that you can't imagine its executives tuning



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into a soft-rock station, let alone getting inside a teenager's head. Stefan Persson, whose late father founded the company, looks and talks more like a financier than a merchant prince. A penny-pinching financier, at that. "H&M is run on a shoestring," says Nathan Cockrell, a retail analyst at Credit Suisse First Boston in London. "They buy as cheaply as possible and keep overheads low." Fly business class? Only in emergencies. Take cabs? Definitely frowned upon. To rein in costs, Persson even took away all employee mobile phones in the 1990s. Today, only a few key employees have cell-phone privileges.

But that gimlet eye is just what a retailer needs to stay on its game—especially the kind of high-risk game H&M is playing. Not since IKEA set out to conquer the world one modular wall unit at a time has a Swedish retailer displayed such bold international ambition. H&M is pressing full-steam ahead on a program that will bring its total number of stores to 844 by the end of 2002, a nearly 75% increase in the past six years. With the Nov. 1 opening of its latest Manhattan store, near Macy's, H&M will have 45 outlets in the U.S. It

FIFTH AVENUE CEO Persson wants the U.S. to drive growth

plans to open a further 20 American stores by yearend 2003. "No other European retailer has managed to

expand so successfully beyond its own borders," says Wills.

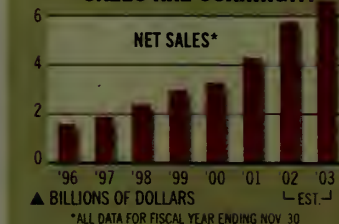
Nevertheless, H&M is pursuing a strategy that has undone a number of rivals. Benetton tried to become the world's fashion retailer but retreated after a disastrous experience in the U.S. in the 1980s. Gap, once the hottest chain in the U.S., has lately been choking on its mismanaged inventory and has never taken off abroad.

Persson and his crew are undaunted. "When I joined in 1972, H&M was all about price," he says. "Then we added quality fashion to the equation, but everyone said you could never combine [them] successfully. But we were passionate that we could." Persson is just as passionate that he will be able to apply the H&M formula internationally.

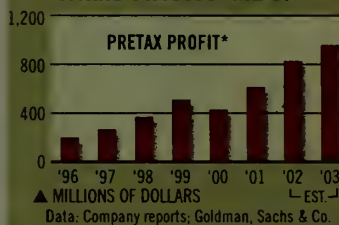
What's that formula, exactly? Treat fashion as if it were perishable produce: Keep it fresh, and keep it moving. That means spotting the trends even before the trendoids do, turning the ideas into affordable clothes, and making the apparel fly off the racks. "We hate inventory," says H&M's head of buying, Karl

H&M: A SWEDISH SUCCESS STORY

SALES ARE SOARING...



...AND PROFITS ARE UP



Gunnar Fagerlin, whose job is to make sure the merchandise doesn't pile up at company warehouses. Not easy considering that H&M sells 550 million items a year.

All major fashion retailers aim for fast turnaround these days, but H&M is one of the few in the winner's circle. All merchandise is designed in-house by a team of 95 in Stockholm. To keep costs down, the company outsources manufacturing to a network of 900 garment shops located in 21 mostly low-wage

countries, primarily Bangladesh, China and Turkey. "They are constantly shifting production to get the best deal," says Johan Tisell, an analyst at Enskilda Securities in Stockholm.

Working hand-in-glove with suppliers, H&M's 21 local production offices have compressed lead times—meaning the time it takes for a garment to travel from design table to store floor—to as little as three weeks. Only Zara, whose parent, Inditex, owns its own production facilities in Galicia, Spain, boasts a faster turnaround—a mere two weeks. Meanwhile, Gap Inc. operates on a nine-

month cycle, a factor that analysts say is to blame for its chronic overstock problem.

H&M's speed maximizes its ability to churn out more hot items during any season, while minimizing its fashion faux pas. Stores are restocked daily—although sometimes, even that's not enough to meet demand. When the Manhattan flagship opened in the spring of 2002, crowds grew so large the store had to be restocked hourly.

Faster turnaround means higher sales, which helps H&M charge low prices and still earn gross margins of 53%, a key measure of a retailer's profitability. But cheap and fast don't cut it unless the fashion sense is there. H&M's



WE PROMISE TO EXPLAIN THE WONDERS OF OUR SYSTEM-ON-CHIP RESEARCH AND HOW SCOTLAND IS SHAPING THE FUTURE OF ELECTRONIC DESIGN.

BUT FIRST WE NEED TO GET PAST THE KILT THING.

The roots of the design can be traced all the way back to the Roman toga.

Longer kilts can be used as a cloak, camouflage, travel bag or sleeping bag.

Kilts were never popular outside of their originating Highlands, where horses were expensive and rare. This is because they are impractical for riding.



The reality is you'll find more Scots donning lab coats than kilts these days.

In electronic design, our innovative Alba Centre is leading the world's R&D in System Level Integration technology, as well as promoting enormously successful collaborations between top universities and private sector partners. And of course, there's Dolly, our now famous sheep who became the first mammal cloned from an adult cell—a direct result of Scotland's thriving and inventive biotech industry.

Today, the question progressive companies are asking us has little to do with matters such as why we wear kilts—and has everything to do with how to gain access to the kind of vast knowledge base Scotland offers.

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SCOTTISH DEVELOPMENT INTERNATIONAL



GIMLET EYE

Design head van den Bosch goes for long skirts, shown below through Avedon's lens

taken decades. H&M founder Erling Persson, who died on Oct. 28 at 85, began his career working for his father delivering cheese to Stockholm res-

young designers find their inspiration in everything from street trends and films to the bazaars of Marrakesh. Despite the similarity between *haute couture* and some of H&M's trendier pieces, copying from the catwalk is not permitted, swears Margareta van den Bosch, head of the design team. "Whether it's Donna Karan, Prada, or H&M, we all work on the same time frames," she says. "But we can add garments during the season."

Although H&M sells a range of clothing for women, men, and children, its cheap-chic formula goes down particularly well with the 15-to-30 set. Are you lusting after that Dolce & Gabbana corduroy trench coat but unwilling to cough up \$1,000-plus? At \$60, H&M's version is a steal. Sure, it's more Lycra than luxe and won't last forever. But if you're trying to keep *au courant*, one season is enough. "At least half my wardrobe comes from H&M," says Emma Mackie, a 19-year-old student in London. "It's really good value for money."

Acquiring this deft touch has

restaurants. During a visit to New York in 1947, Persson marveled at the success of retailers such as Macy's. Upon his return, he launched small women's clothing chain Hennes—Swedish for "hers." The store's low prices proved a huge hit in Sweden, where retailing, as in the rest of Europe, was at that time still dominated by pricey department stores. By 1968, Hennes had morphed into H&M with the acquisition of Swedish men's retailer Mauritz, and its stores were dotted across Scandinavia. But it wasn't until after Stefan joined the company that H&M's international expansion really took off.

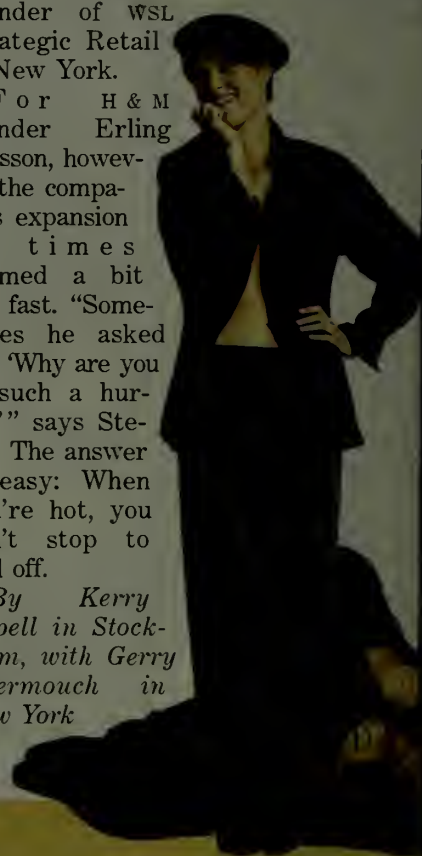
Persson's goal now is to enter a new country every second year. This year, the Swedish retailer is stepping into Portugal. Italy, Canada, and Eastern European nations may be next. The make-or-break market for H&M, though, will be the U.S., since 9 of the 13 European countries in which H&M operates are mature markets for the retailer. Breaking in hasn't been easy. Many of the U.S. outlets that H&M opened in

2000 were too big. The entire top floor of its massive 5,400-square-meter store in Carousel Center in Syracuse, N.Y., now sits empty. Poor location was another teething problem. H&M blundered when it set up shop in suburban Livingston Mall in Newark, N.J. The mall is dominated by numerous inexpensive chains such as Express, Old Navy, and Wet Seal, making it hard for H&M to stand out.

But H&M is learning from its mistakes. During the third quarter, it managed to halve the losses from U.S. outlets, to \$6 million, and these are expected to break even by the end of 2002. "They've been quite sensible compared with other European retailers in the U.S.," says Wendy Liebmann, founder of WSL Strategic Retail in New York.

For H&M founder Erling Persson, however, the company's expansion at times seemed a bit too fast. "Sometimes he asked me: 'Why are you in such a hurry?'" says Stefan. The answer is easy: When you're hot, you don't stop to cool off.

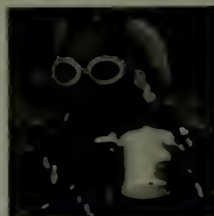
By Kerry Capell in Stockholm, with Gerry Khermouch in New York



CLASH OF THE CLOTHING TITANS

	STYLE	STRATEGY	GLOBAL REACH	FINANCIALS
	Motto is "fashion and quality at the best price." Translates into cutting-edge clothes.	Production outsourced to suppliers in Europe and Asia. Some lead time is just three weeks.	Has 809 stores in 14 countries. More than 88% of sales come from outside Sweden.	Estimated 2002 pretax profit of \$833 million on sales of \$5.8 billion.
	Built its name on wardrobe basics such as denim, khakis, and T-shirts.	Outsources all production. An average of nine months for turnaround.	Operates 656 stores in Canada, Japan, and Europe, which produce 8% of sales.	Estimated 2002 pretax profit of \$554 million on sales of \$13.8 billion.
	Billed as Armani on a budget for its Euro-style clothing for women and men.	Bulk of production is handled by company's own manufacturing facilities in Spain.	Runs 507 outlets in 30 countries, but Spain still accounts for 50% of sales.	Parent Inditex does not break out sales. Data: Company reports, Santander Central Hispano, BNP Paribas, Goldman, Sachs & Co.

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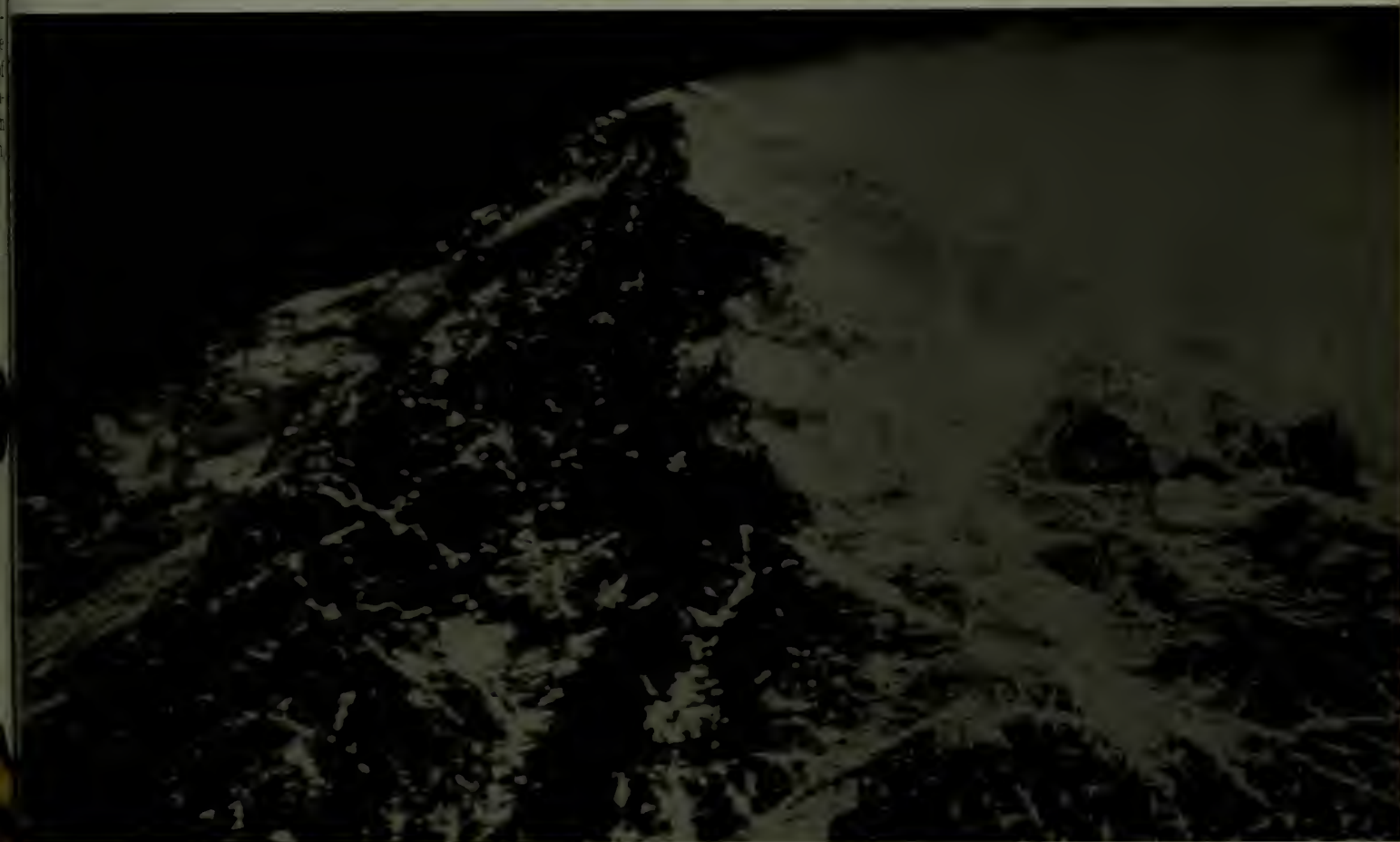


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CAN STODGY GM TURN STYLISH?

Cost-saving technology could put concept cars on the road

Don't ever say General Motors Corp. can't design cool road machines. Long derided for its low style quotient, the world's largest carmaker lately has been dazzling auto show crowds with its concept models. Last January at the Detroit show, company Vice-Chairman Robert A. Lutz wowed his audience with the Pontiac Solstice two-seat roadster. A few months later, GM's *tour de chic* hit Chicago, where Lutz and crew unveiled the ultracut Saturn Sky convertible. The year before, even stodgy Buick turned heads with the stylish Bengal coup.

So why aren't GM's cars lighting up dealer showrooms as they do auto shows? Because most of the hot prototypes prove too costly to make. Indeed, Lutz and his boss, CEO G. Richard Wagoner Jr., would

love to shine up dull divisions such as Saturn, Buick, and Pontiac with new models. But GM has a tough time justifying the \$400 million it takes to get a new vehicle into production—especially if the vehicle and its offshoots are expected to sell fewer than 80,000 units a year. That's the magic number GM typically aims for to cover the costs of tooling up for a new model, salaries for its union workforce, and the huge pension costs of its 450,000 retirees. "Niche cars bring

excitement to the brand and people to the showroom," Wagoner says, "[but] you don't want them to be profit-eaters."

The solution to GM's woes may already exist in a combination of technologies GM itself helped to perfect. The first, which the carmaker began to explore in the mid-1980s, is beguilingly simple: build autos around a "space frame"—a single welded structure that integrates a safety cage with the heavy rails that give a car its stiffness. To make this frame, GM hopes to use a second trick its engineers came up with: "hydroforming" space-frame components. Instead of shaping the frame using costly stamping components, the metal is molded using ultra-high-pressure water. Together, the two technologies promise to help GM get new models rolling for \$100 million to \$200 million—less than half today's price. What's more, they offer designers new, more flexible ways to shape the body panels that give a car its character.

GM could certainly use a few hot cars. While its truck sales continue to surge, passenger-car sales are down 8.4% this year. GM lately has been spending thousands of dollars per car on advertising and rebates while offering 0% financing to keep them selling. Foreign auto makers are far better at rolling



SHOWSTOPPER:
The Pontiac Solstice two-seat roadster

CRAFTING AN AFFORDABLE DREAM CAR

GM hopes new technologies will enable it to make a wider array of car styles in smaller batches

SPACE FRAMES LIGHTEN THE LOAD...

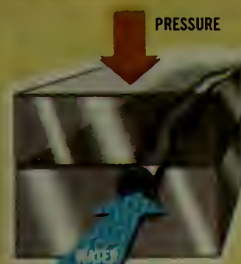
GM is increasing its use of space frames—rigid internal structures on which lightweight body panels can be hung. Conventionally built cars require heavier steel panels to strengthen the frame.



SKELETON OF THE SATURN VUE

...WATER MOLDS METAL PARTS...

Vehicle frames are now shaped into complex forms using costly stamp-and-die processes. GM hopes to "hydroform" them instead, using high pressure water to expand metal tubes into a mold.



...AND GM FINDS BIG SAVINGS

Hydroformed space frames promise to lower tooling costs so much that GM expects to roll out a new model for about half the current expense.



COST TO DEVELOP A NEW MODEL CAR
Data: General Motors Corp., BusinessWeek

out niche-mobiles as well as small-run luxury models—and it's done largely without financial sweeteners.

Consider the Mini Cooper, a limited-run roadster that has created big buzz for BMW. The hard-to-find model has some buyers waiting four months for delivery. Plus, the retro coup holds its value better than any other car, according to *Automotive Leasing Guide*. It follows that if the U.S. giant can economically build the Solstice—a jazzy two-seat sports car—"it would do wonders for GM's image," says Rebecca Lindland, an analyst for Global Insight Inc., an auto-industry research firm in Boston.

GM's hydroformed space frame could make that happen. Since the frame does all of the structural and safety work, GM could make several different sports cars—say, the Solstice, Sky, and Bengal—using a lot of the same hardware underneath the skin. And that skin need not be heavy-gauge steel, as in most of today's cars. Both the Saturn ION compact and the VUE sport-utility vehicle have a conventionally manufactured space frame, but GM is using plastic body panels that are cheaper to make and fix. Since they're lighter, the cars also gain an edge in mileage. The space-frame option also means that different models could be assembled on the same compact-car platform and in the same plant, says Mark T. Hogan, GM's group vice-president for advanced vehicle development. That would let GM further cut initial spending on the sports cars by borrowing parts from other small models and by boosting productivity at its plants.

Synergies like these promise big savings for GM. The load-bearing beams for conventional car frames are made by stamping thick sheet metal into a lengthy trough with a U-shaped cross section. Two of the resulting beams are welded together to make the strong rails that form the foundation of the frame. The stamping dies used to press the steel sheets cost some \$250,000 apiece. That's because these machines are engineered to be both super-durable

and highly precise. They're able to generate hundreds of heavy metal forms an hour, each to millimeter accuracy. Each new car model needs about 400 such dies, or \$100 million worth. The dies are so precious that before union workers at GM's Flint (Mich.) truck plant walked off their jobs for two months in 1998, GM moved the dies for its new pickup trucks to another plant so production would not be interrupted.

Hydroforming tools cost far less since water, rather than metal dies, delivers

Using the two technologies together will be a first for GM. Both, however, already have proven themselves on the road. In the mid-1980s, GM used conventional stamp-and-die methods to build its first space frames. At first, the complexity and cost of assembling the frames proved daunting. By 1990, the costs had fallen enough for the auto maker to start using conventionally assembled space frames in its Saturn line. GM began hydroforming frame elements in 1998, and they've since proven tough enough to use as frame members in the Chevy Silverado full-size pickup as well as the Corvette sports car and the midsize Trailblazer SUV.

Can space-frame technology solve GM's production bottleneck? GM engineers are hopeful, but they acknowledge that it's hard to dislodge proven methods. For example, some GM insiders have proposed building the Solstice using conventional technology. Yet GM design studios are littered with blueprints for futuristic models that couldn't be built using the old ways. GM's latest such bid is the Chevy SSR, a combination hot rod-pickup truck, which is turning into an expensive gamble. To develop the pickup economically, GM borrowed hardware from its midsize SUVs. The SSR will still debut next summer, say GM sources, but its costs have already ballooned beyond

its original \$300-million budget. "There's a strong learning effect," Lutz concedes.

If Lutz wants to come through on his wish to decorate each U.S. division with a fresh, stylish car, GM's engineers will have to find a way around cost overruns. Hydroforming and space-frame technology are the most promising—but GM still seems to be waffling. Nonetheless, the carmaker is jumping through hoops to make the twin technologies work and come up with cash to build the Solstice, Bengal, Sky, and, if everything goes well, the Hummer H4, a Jeep-like addition to the Hummer family. "We think it can work," says Lutz. But if GM can't cut costs, Lutz and his team may never see that auto-show magic reenacted where it really counts: in the showroom.

By David Welch in Detroit

THE SATURN SKY
CONCEPT CAR



WATER WINDFALL

GM's high-tech revamp of the frames on which it builds cars should bring myriad benefits, including:

COST SAVINGS By hydroforming steel tubes, GM can cut the cost of developing the tools to make a car's frame and body to \$30 million from \$150 million. Total development costs should fall to less than half of today's \$400 million price tag.

SMALL, EFFICIENT PRODUCTION RUNS Today, the carmaker's minimum run is about 80,000 units per vehicle family per year. Lower-cost space-frame models mean GM can afford to make much smaller batches. Also, they may make it easier to produce a variety of models on one line, improving productivity.

FLEXIBLE STYLING Space frames are so strong—and safe—that GM can replace steel body panels with lightweight steel or aluminum. This also will help GM freshen dated designs with minimal investment.

the force. Instead of stamping sheets into long beams, pipelike steel tubes are placed into a die. Water is then blasted into the tubes at such high pressure that the steel expands like a balloon, filling even the tiniest forms of the mold. Hydroform dies can even be bent into complex forms that would be more costly and difficult otherwise.

All told, the conventional die-and-stamp tools needed to make a frame and body on a new car can cost up to \$150 million. That figure falls significantly—some say by up to 75%—if GM relies instead on hydroforming tools, used together with a smaller set of stamps. Applied to the Solstice, for example, GM's target for initial development costs is \$100 million, though some insiders say \$200 million is more realistic.

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Although it's probably one of the true clinchers, the CEOs are loath to divulge another, more personal reason. "Because I wanted to live and work in Budapest." That expatriate (expat) executives do flock to Budapest is confirmed by Hungary's investment experts.

"In our work, we deal with a large number of newly-arrived expat executives. They report that Budapest has the reputation in the business world of being a very attractive posting," notes Csaba Kilian, head of international investment at Hungary's Investment and Trade Development Agency. "And that's because Budapest offers everything the executives and their families need to feel at home," he adds. These necessities include a complete chain of international instruction. The first link in the chain is formed by the three English-language daycare centers located in Budapest, which also has three international schools.

Students graduating from them can go on to the English-language degree programs offered by the country's major domestic and international universities. Prominent among the latter is the newly-founded Central European University. German-speakers attend the Andr ssy-Gyula University, which opened its doors in September.

"Budapest is a paradise for expat executives, as the city provides them with all of the basic necessities," notes Istv n V mos, president of the Colorado-based Advanced Forming Technologies. The com-

pany maintains a facility north of the city.

These "necessities" include 28 cinemas showing movies in English, an incredible variety of expat-focus clubs, a good selection of Irish pubs, Tex-Mex restaurants and other staples of international wining and dining, and an English-language daily—the Budapest Sun—reporting on them all.

As is the case with the reports and reviews appearing in the weekly Budapest Business Journal, Budapest Zeitung and Pester Lloyd (the latter two in German), the Sun's listings are eagerly consulted by the international community, as are its reports on what to do and where to go in Budapest. Receiving equally avid attention are this lively newspaper's ads, a large percentage of which are for relocation services.

These services cover everything from finding housing, schools and physicians, helping with securing visas, drivers' licenses and automobile registration to calling plumbers, organizing get-togethers and translation of official documents for their customers.

"We don't want to forget other important factors making Hungary so attractive to expat executives. As our international tourism figures amply detail, Budapest is one of the world's most beautiful and cosmopolitan cities. And Hungary is chock full of other charming cities and villages, plus wondrous nature, wines and festivals," adds Kilian.

Get ready for "jumping over." It has just joined "trading up" as the most important pattern of international investment in Hungary. Trading up was the dominant pattern of the last decade, which started with General Electric, Audi, Philips and many other business superpowers flocking to acquire or set up facilities in Hungary. These first-wave investments generally involved component assembly and other low-end, non-capital intensive work.

Thanks to the skills and motivation of Hungary's well-qualified work force, these initial investments worked out well—so well that these companies have spent the

How's this for a track record?

One of the longest winning streaks in the world

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One of the best performing economies in 2002

-a rate of economic growth which is top in central and Eastern Europe and twice that of the European Union.

	1999	2000	2001	2002 (January - June)
GDP change in %	4.2	4.5	3.8	3.0
Industrial Production change in %	10.4	18.6	4.1	1.1
Rate of Unemployment %	7.0	6.4	5.7	5.6
Exports rise in %	8.7	12.3	11.8	7.8
Imports rise in %	9	14.5	7.8	4.4
Total FDI in Euro billion	20.7	23.5	26.2	26.9

Source: Central Statistics Office

New in 2002: New companies, new areas, and new patterns of investment in Hungary

years ensuing increasing the size of their operations in the country. While doing so, many of these companies have also converted these operations into high-end development and manufacturing (D&M) facilities.

The process is called "trading up" in the parlance of the business world. "Jumping over" is when a foreign company skips the intermediate steps, and establishes an ultra high-end D&M facility in a country. And jumping over is increasingly the norm in Hungary nowadays.

Take Advanced Forming Technology (AFT). Based in Colorado, it is the world's leader in metal injection molding (MIM). This technology is used to create the complex, high-performance components forming the heart of jet engines, communication devices and industrial systems.

In April, 2002, AFT opened a state-of-the-art, \$10 million MIM facility in Rétság, a town located 60 kilometers north of Budapest. With literally its pick of every site in

Europe, why did AFT decide to jump over to Hungary?

"For three key reasons: quick times of investment realization, a great location and high quality human resources," states István Vámos, AFT's president. "It took us only 12 months to turn a blueprint into a facility ready for operation. Hungary provides us with no-delay access to our European customers."

He adds: "But most important was Hungary's work force. In our business, quality is everything. Our components are subject to the most demanding of conditions over very long periods of time. They have to work perfectly each and every time. It takes qualified, dedicated persons to operate and monitor the advanced systems turning out such parts."

In selecting Rétság, AFT was setting forth another of the trends gripping Hungary's inward investment scene: the expansion out of Budapest and the country's western rim—traditionally the areas receiving the

lion's share of international capital—and into Hungary's northern, eastern and southern reaches.

"An attractive selection of affordable sites, American-standard communications, power supply and transport infrastructure, and the willingness of qualified personnel to commute from Budapest—or to relocate to northern Hungary," states Elek Bindics, explaining why the Virginia-based Tredegar Film Products also decided to set up a production facility in northern Hungary. Turning out plastic films and based as well in Rétság, the facility was commissioned in 1999.

"I do think our track record has encouraged other international companies to follow suit," adds Bindics. During its first three years of operation and thanks to two expansions, the facility has quintupled its output. While doing so, Rétság has achieved the highest product quality of Tredegar's 13 facilities.

Written by Terry Swartzberg
Designed by dotCOMMS.net

Hungary

The Republic of Hungary



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AUTOMOBILES

FORD: LUXURY IS JOB ONE

The profits aren't there. Will expanding volume help?

Mike Price is thrilled with the silver 2003 Jaguar S-Type sedan he bought in September, calling it "smooth as silk." The retired New Orleans oil-company manager has long admired the elite British sports-car maker, now owned by Ford Motor Co. Yet he ended up trading in his last Jag, the new small X-Type, because of glitches, and upgraded to the larger \$50,000 model he now owns. He frets that production flaws in the first year's X-Type, and selling the cars with discounts risks cheapening the Jaguar brand. As happy as he is with his new car, all that has made him anxious about its resale value. Laments Price: "I only hope that in Ford's desire to increase profits that it doesn't compromise those qualities that have set Jaguar apart from its rivals."

Price isn't alone. Lately, investors, Wall Street analysts, and Ford executives themselves have voiced similar concerns. Ford is taking Jaguar to the masses, and the Dearborn (Mich.) company is betting that the profits from the sale of more high-priced cars will fatten up Ford's anemic bottom line. So far, however, the heavy reliance on luxury is proving to be a bust—mostly because of problems at Jaguar Cars Ltd.

Back in January, when Chief Executive William C. Ford Jr. unveiled his turnaround plan for Ford, he singled out Ford's collection of luxury cars, the Premier Auto Group (PAG), as a prime force in Ford's recovery. He promised investors that the luxury brands—Jaguar, Volvo, Land Rover, Aston Martin, and Lincoln

(since moved out of PAG)—would deliver fully one-third of corporate profits by mid-decade. Now, though, it looks as if Ford tried to ramp up production too quickly. Jaguar sold 101,000 cars last year, and sales have risen 49% so far in 2002—

cars last year, but sales are off 2% so far this year. Ford has changed Volvo's leadership in the U.S. and is working to improve its marketing. And Land Rover, with sales of 164,000 vehicles in 2001, has been an automotive money pit. In 2001 alone, it lost an estimated \$236 million, says Morgan Stanley analyst Stephen Girskey. It probably won't do much better this year.

The stumble in luxury cars was one of the major reasons that Standard & Poor's on Oct. 25 downgraded Ford's credit rating to BBB, two levels above junk status. Ford shares have lost nearly 50% of their value since January, and trade around \$8. "We need to see some tangible evidence of progress toward improved profitability," says Scott Sprinzen, a Standard & Poor's managing director. "They



but at a cost of numerous quality snafus. Meanwhile, amid brutal competition in the luxury segment, Ford resorted to overly aggressive financing and still faces high development costs for future models. The result: Jaguar will post an estimated \$500 million loss this year, say Ford officials. That will likely throw the whole luxury group into the red.

While most of the problems are at Jaguar, the rest of PAG has not distinguished itself, either. Volvo sold 412,000

have a long way to go." Until PAG—run since April by former Mazda Div. chief Mark Fields—recovers, Ford will have a tough time making the money it needs to invest in new cars and trucks.

The original architects of the PAG expansion were former Ford CEO Jacques A. Nasser and his luxury chief, Wolfgang Reitzle. Reitzle left last spring after it became clear he didn't have a shot at replacing Bill Ford as CEO. But Ford did adopt the ambitious goals for luxury



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"We stumbled this year at Jaguar," concedes Bill Ford. "We were too ambitious with our growth expectations"

growth. He wanted to more than double PAG's share of Ford profits from 2000 to 2005. That meant ramping up output of the four European brands to more than 1 million vehicles from 673,000.

Many of the new cars would be more-affordable models intended to lock in the brand loyalty of younger buyers. True, Volvo is aiming to increase its sales of upscale family vehicles by almost 50% and Land Rover hopes to expand its luxury SUV niche by roughly 40%. Aston Martin (which sells 1,500 cars a year) is too tiny to make much difference. But it is blueblood Jaguar, with plans to double sales within a few years, and a flurry of new model debuts from the X-Type to the updated S-Type and next year's upscale new XJ, that is now bearing the brunt of rapid expansion. The thinking in Dearborn was that if Mercedes-Benz could successfully expand into entry-level luxury with its C-Class cars and BMW with its 3-series, why couldn't Ford do the same with Jaguar?

Where Ford seems to have gone wrong is in how fast that should happen. Sure, BMW now sells 906,000 cars a year. But it took them more than 20 years to nearly triple worldwide sales. "Jaguar expected too much volume too quickly," says Susan Jacobs, an analyst at Jacobs & Associates in Rutherford, N.J. Even Bill Ford now agrees: "We stumbled this year at Jaguar. We were too ambitious with our growth expectations, and we stretched Jaguar to the limit."

The latest Jaguar, the \$30,000 X-Type—the "baby Jag"—began rolling off Ford's Halewood (England) production lines last fall and hit the U.S. in September. It extended a line that tops out at \$95,000 for a fully loaded XKR convertible. Although the X-Type wowed new buyers, it soon annoyed them with a series of production *faux pas*, such as hesitating engines and faulty trunk latches. That pushed up warranty costs and dragged Jaguar down 17 notches in the latest J.D. Power & Associates Inc. initial quality survey, to 19th place. Worse, it marked a major reversal for Jaguar's image. Since buying the company, Ford had spent hundreds of millions of dollars to improve Jag's once notoriously poor quality, which at one point rivaled that of the Yugo. The X-Type just revived those memories.

The fact that the X-Type was built on

the chassis of the cheaper Ford Mondeo compact also cheapened Jaguar in the minds of some buyers. "Component-sharing is fine, but it can be trouble if it gets to the point that people start thinking, 'Gee, this is just a gussied-up Ford,'" says Christopher W. Cedergren, managing director of Nextrend Inc. auto consultants in Thousand Oaks, Calif.

As the bottom of the luxury car market got increasingly crowded, BMW and other luxury auto makers offered cheaper lease deals—but did it discreetly. Jaguar, on the other hand, trumpeted a \$369-a-month lease on its new car. In auto parlance, it was blatantly "selling the deal" rather than the car—a major gaffe for a marque known for exclusivity and taste. Ford admits the cheap leases cost it money.

In fact, the sales outlook became so bleak that in September Ford cut production of the X-Type to 75,000 cars annually from 90,000. The rest of Ford's luxury offerings suffered, too. With high manufacturing costs at its Solihull (England) facilities, Land Rover may still be in the red, despite rising sales—up 6% this year.

SPEED BUMPS FOR FORD'S LUXURY GROUP

- Ford tried to expand Jaguar production too quickly, taxing manufacturing capabilities and resulting in snafus such as wobbly car seats and hesitating engines
- High marketing costs for the "Baby Jag" X-Type and steep expenses for new car launches mean Jaguar will lose \$500 million this year
- Volvo, the largest of Ford's luxury makes, remains a disappointment, with sales falling 2% this year, its second straight decline

Volvo, meanwhile, is just starting to perk up, thanks to the arrival of a highly regarded new SUV, the XC90. Ford feels that Volvo, while moving away from its boxy look in the mid-1990s, never really lived up to its potential in the U.S. Now it has a new marketing chief and a plan to get back to its long-standing message of safety with performance.

CEO Ford has tried to reassure skittish investors by reconfirming the importance of the luxury group. Ford says the

group is rebounding, and he still expects it to kick in what

amounts to \$2.3 billion of a total \$7 billion pretax operating profit in 2005.

"Overall, the PAG strategy is still sound," Ford insists.

Luxury group chief

Fields says the group needs "a period of consolidation," but he

doesn't plan to

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profitability,

Fields says

"not just

FIELDS: Under the gun

blindly pursuing volume." He also thinks

it will help when the number of Jaguar

and Land Rover dealers in the U.S. in

creases, and as more of them sell both

brands—a transition that is under way.

Buyers of those lines are similar demographically, and Ford believes the vehicle

lineups are complementary.

Ford's supporters say recovery will

be painful, but they expect the luxury

strategy to eventually pay off. Expanding

a niche brand is a slow process,

says Wilmington (Del.) dealer Frank

Ursomarso, who owns Jaguar, Volvo

and BMW franchises. He adds: "I believe

they're going to need a little more time

than the bozos on Wall Street are giving

them." Ford has to hope that its luxury

bet pays off, and it winds up having

the last laugh.

By Kathleen Kerwin in Dearborn

Mich.

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ACCOUNTING

STILL SPINNING THE NUMBERS

Citigroup, IBM, and others are putting a gloss on the numbers in third-quarter announcements

Despite months of accounting scandals and widespread criticism of hyped results, some companies just don't seem to get it. Citigroup, Northrop Grumman, and BellSouth, among others, all dressed up their recent third-quarter announcements in creative—though legal—ways. “There is still a tendency to use too much spin in press releases,” says Philip Livingston, president of Financial Executives International, a trade group of financial officers and controllers.

The Securities & Exchange Commission is under congressional orders to stomp out the bad stuff and put rules about earnings releases in place by February. It offered a foretaste on Oct. 30, when it sketched out new regulations that would require companies to show

how numbers they present differ from generally accepted accounting principles (GAAP). The SEC also aims to stamp out “material misstatements or omissions” in company announcements.

But the reform drive hasn't quite quashed the temptation for companies to put the best possible spin on their numbers. Consider Citigroup's third-quarter earnings announcement on Oct. 15. The financial behemoth counted the gain from the sale of its headquarters on New York's Park Avenue for \$1 billion toward what it calls “core earnings,” a measure of ongoing operations. The \$323 million after-tax profit from the one-time transaction generated half of the 19% growth in Citi's core earnings.

Citigroup CFO Todd S. Thomson says accounting rules required it to count the gain. It was also fair because the bank's business includes a property investment portfolio. Besides, he says, most of the real estate gain booked was from the 60% of the building it had leased to other companies; gains from space it occupies itself are being taken over

15 years. GAAP discourages exclusions of all but the most extraordinary losses and gains from results. But counting it as part of its ongoing “core earnings” won't reassure its investors. “Including it was a matter of judgment erring on the side of aggression,” says Lawrence A. Cunningham, professor of law and business at Boston College. “It is out of step with the climate.”

Thomson says the gain is one of several items. For example, Citi reduced core earnings by \$215 million for fines it paid to settle government charges about practices years ago by Associates First Capital Corp., a consumer-finance company it bought in 2000. However, it doesn't help that Citi omitted a key fact when it compared its results with last year's: It didn't highlight that, because of an accounting rule change, it didn't have to reduce

THE EARNINGS GAME

A host of legal, but still surprising, tactics made third-quarter earnings look better for these companies

CITIGROUP

Reported a \$323 million gain on the sale of its Manhattan headquarters as “core earnings.” The amount accounted for half the 19% gain in the quarter.

NORTHROP GRUMMAN

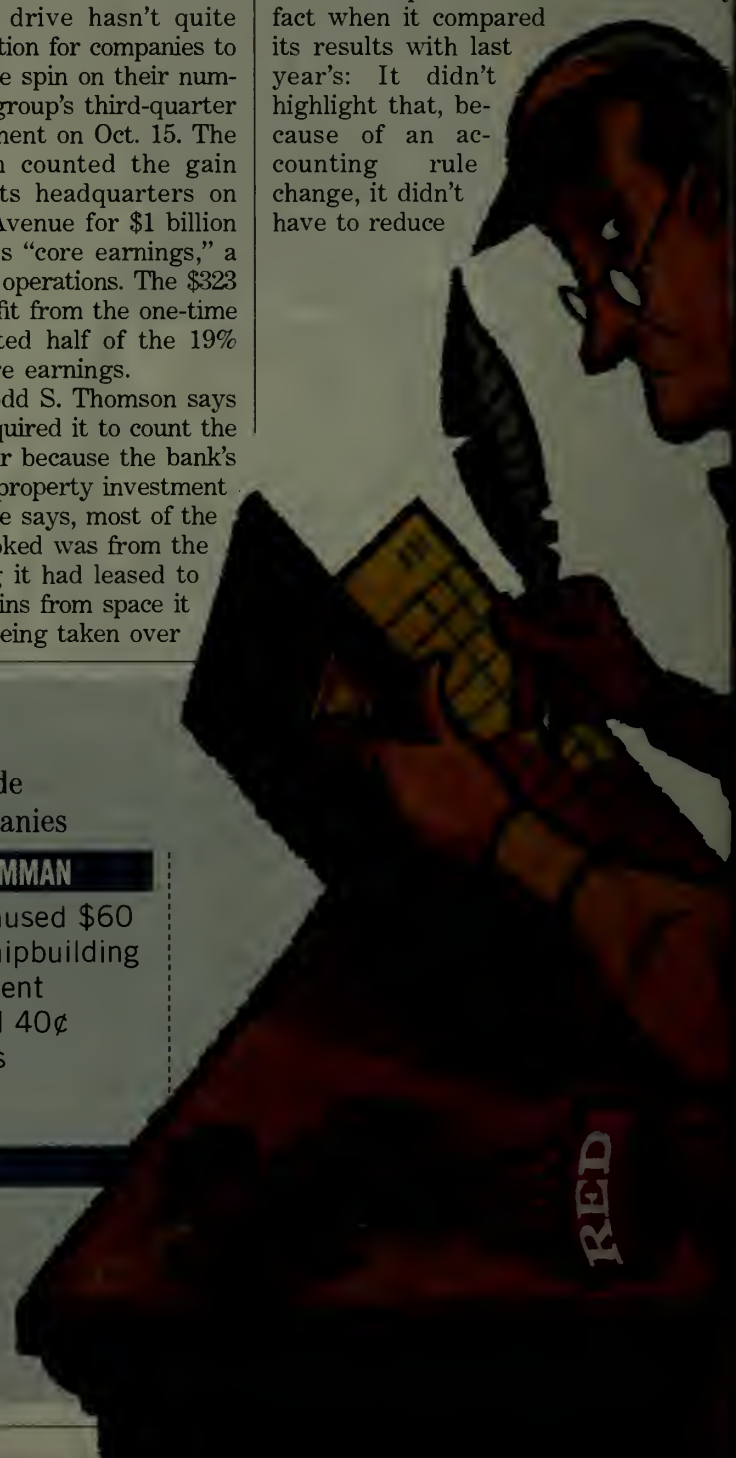
Reinclusion of an unused \$60 million reserve for shipbuilding costs after a buyer went bankrupt contributed 40¢ of its \$1.17 earnings per share.

BELLSOUTH

Announced “normalized earnings” that excluded currency losses, a tactic that has increased earnings by 19% so far this year.

IBM

Half of a 2¢ rise in earnings from continuing operations came from real estate sales.



earnings by about \$100 million a quarter to amortize goodwill this year, as it did last year. The apples-to-oranges comparison made the latest results look 3% better. Thomson dismisses the matter as "not a huge number for us" compared with peers.

Last year, Citi did think it was important. Then, it showed in its handout how much more the company would have earned had the rule change already been in effect. The Financial Accounting Standards Board, which ordered the change, also thought it was important to require companies to show its impact in official quarterly reports filed with the SEC a few weeks after earnings announcements. "This is very disappointing," says Charles L. Hill, research director at earnings tracker Thomson First Call. "They should just put it in the earnings release, too."

Citi wasn't alone in stretching the definition of ongoing business. A full 10¢ of the \$1.17 per share earnings Northrop Grumman Corp. reported on Oct. 17 came from taking back into profits a \$60 million reserve made a year earlier to cover the cost of halting construction of two cruise ships whose buyer went bankrupt. Northrop no longer builds cruise ships. But, says spokesman Frank Moore, the transaction reflects work done in the third quarter when Northrop found a buyer.

Poppycock, says Robert E. Friedman, a stock analyst and accounting expert at Standard & Poor's: "It is a distortion of

current earnings performance. It should be stripped out in calculating the company's underlying earnings."

Some companies are still learning. Earlier this year, IBM caught a lot of flak for not disclosing that an asset sale had been used to cut corporate overhead by some \$280 million. Subsequently, it stopped the practice and increased disclosure. But in its most recent earnings conference call, on Oct. 16, the company volunteered that real estate sales had lifted earnings by \$29 million, or 1.7¢ a share pretax—a point that wasn't in IBM's written earnings announcement. Small though it sounds, the gain accounted for more than half the 2¢ improvement in IBM's per share earnings from last year's third quarter. Chief Financial Officer John Joyce conceded in the call that IBM is not in the real estate business but argued that the company's ongoing outsourcing business frequently leaves it with assets to sell. "We pride ourselves on straight talk to investors," says spokeswoman Carol Makovich.

Even companies that apparently lay everything out sometimes hide important items in plain sight. BellSouth Corp. is meticulous in reconciling its preferred "normalized earnings" accounting with GAAP, setting out the differences in tables instead of dense text. The problem: a confusing 10 columns of variations from GAAP for investors to sort through. A close scrutiny of the

latest quarter's table shows that 30¢ out of \$1.59, or 19%, of normalized earnings per share this year came from not deducting losses on foreign exchange. Virtually all other companies count any currency losses when figuring their announced earnings, according to Joseph W. Cooper, research analyst at Thomson First Call. BellSouth spokesman Jeff Battcher says, "Our exposure to Latin American currencies is so great that this gives investors a better snapshot of our business."

To be sure, there have been significant improvements in recent months. Many companies are giving investors more information in their earnings releases than before. A survey of 2,400 members of the National Investor Relations Institute found more than four-fifths of companies now include balance sheets. Many are also giving cash-flow state-

ments—which in the hands of a skilled financial analyst can give a quick check on whether accounting tricks have been used to give earnings a lift.

The new SEC rules should help clean up numbers some more. But they won't stop every executive from playing the gray areas of accounting judgments. If executives will spin numbers in this environment, they will in any. Investors will always need to look out for themselves.

By David Henry with Heather Timmons in New York

Many companies are giving investors more information these days, but lots of them are working the gray areas

DUELING MARKET SWAMIS

The consternation over what counts toward profits is never more intense than in the seconds after a company announces its latest earnings and investors try to figure out whether it has hit or missed Wall Street estimates. For years, market pros have relied heavily on those compiled by Thomson First Call in deciding whether to bid a stock up or down.

Now, TheMarkets.com, a joint venture of 11 major Wall Street brokerages, is challenging First Call's supremacy. On Oct. 29, it announced that it will offer links to analysts' accounting explanations with its new estimate-tracking service. First Call began phasing in a similar tool on its First Call Analyst site in the spring.

The competition should result in more com-

plete information. For example, both services aim to show with the click of a mouse whether analysts include restructuring charges and losses on assets that some companies say should be ignored. The goal: to give clients a chance to weigh alternative opinions on the most useful way to track companies' earnings.

Until now, the few analysts whose methods were at odds with the view of the majority had a hard time being heard: First Call used to discard their estimates. David F. Eisner, CEO

of TheMarkets.com, says: "Institutional investors want to delve behind the bottom-line number to understand how it was calculated."

Indeed, with accounting issues quickly moving stocks, no investor can afford to accept a single earnings number at face value these days.

By David Henry in New York



COMMENTARY

By Robert Berner

BEST BUY? MAYBE NOT FOR INVESTORS



For four years, investors have loved Best Buy Co., the nation's largest electronics retailer, and its exuberant growth. The stock soared during the bull market and beat the major indexes well after the bears took over. But since April, the company has said three times it would miss Wall Street earnings forecasts because of unforeseen costs at three companies it has bought since December, 2000. On one occasion, Sept. 5, it took a \$348 million charge, because two acquisitions—Musicland and Magnolia Hi-Fi—weren't worth their purchase prices. Its stock price has fallen by 57% since early April.

Best Buy says a weak economy and a drop in big-ticket sales hurt its business. But the pattern of nasty surprises at Best Buy's acquisitions raises the question of what more might be lurking. What would reassure investors is a detailed explanation of the accounting for Future Shop, a Canadian electronics chain Best Buy acquired in November, 2001,

for \$377 million. While Best Buy's treatment of Future Shop seems to comply with accounting rules, four accounting experts *BusinessWeek* interviewed say a key question remains: Why did Best Buy cut Future Shop's value by \$99 million after it bought the company?

The chief issue is this: Future Shop's July, 2001, accounts, its last before the deal, show the net value of its assets, minus liabilities, as \$61 million. That excludes \$12 million of goodwill—premiums paid for past acquisitions—that Future Shop listed in its Apr. 7, 2001, annual report.

Yet, when the deal closed Nov. 5, 2001, Best Buy said Future Shop was worth -\$38 million. What did Best Buy find to cause a nearly \$100 million drop in value? Future Shop, by all accounts, was prospering.

In written responses to questions, Chief Financial Officer Darren

Jackson says several factors raised Future Shop's liabilities and cut its assets. On the liability side, the company set aside reserves for "probable exposures" to U.S. and Canadian taxes. It also increased liabilities to reconcile differences in the two countries' accounting. U.S. rules required it to book certain lease costs sooner than Canadian rules and to book revenues from service contracts more slowly. As for asset values, he says, Best Buy wrote down goodwill and cut the value of an obsolete checkout system. Jackson also said "normal changes in business volume" affected Future Shop's balance sheet, but did not give details.

Jackson says Best Buy has a year from its purchase to adjust Future Shop's value. The Securities & Exchange Commission, he adds, asked for no restatements when it reviewed Best Buy's numbers for the last two fiscal years as part of increased scrutiny

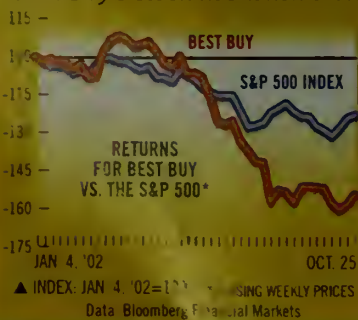
of big companies. But Jackson would not provide—despite *BusinessWeek's* repeated requests—a breakdown of the changes in Future Shop's value. Public filings only show how it allocated the purchase price to broad categories of assets and liabilities. Jackson says he can't say more because of "competitive reasons" and "the constraints of" SEC Regulation Fair Disclosure, which bans companies from giving information only to some investors. But Reg FD wouldn't stop Best Buy from better explaining the drop in Future Shop's value.

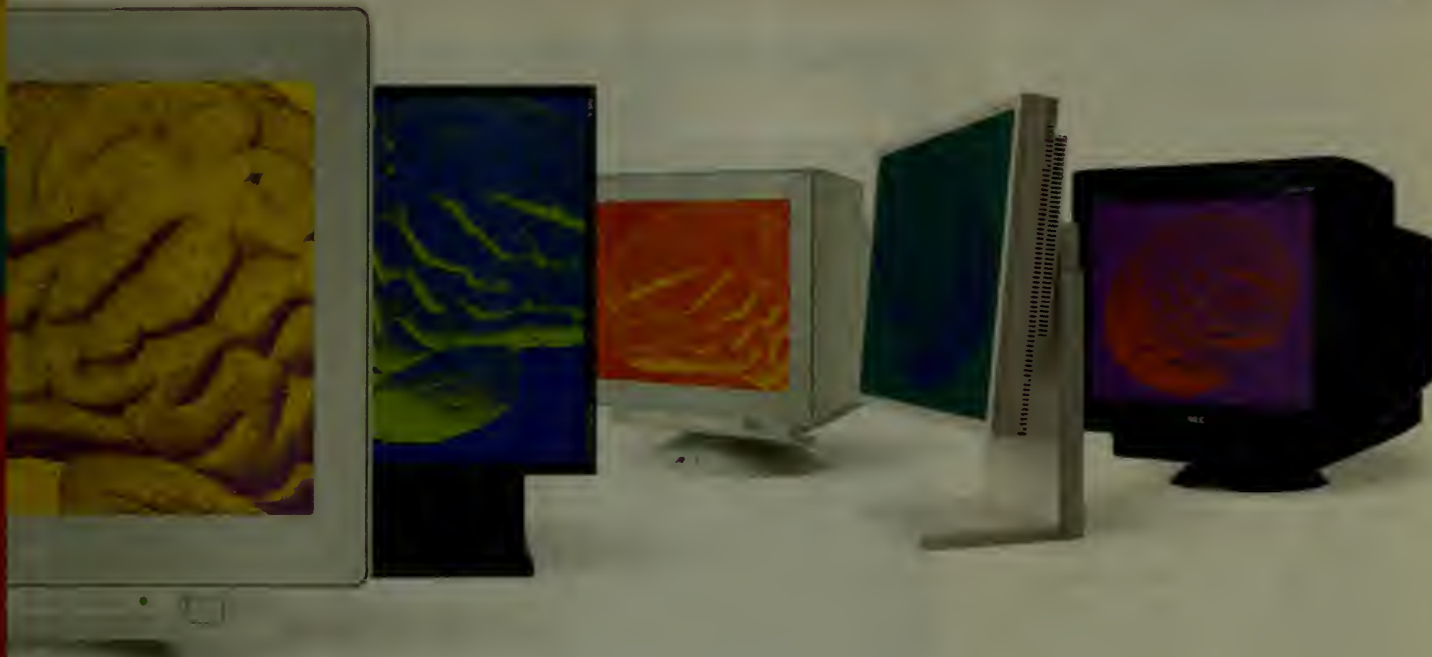
The accounting experts *BusinessWeek* interviewed say the size of the change raises concerns that Best Buy may have used loose rules for merger accounting to obscure merger costs and make sales look more profitable after the deal closed. Such tactics would have made Future Shop's earnings appear to explode.

In fact, Future Shop's 5¢ a share contribution to Best Buy's earnings for the fourth quarter ended Mar. 2

TOO MANY DUDS?

Hurt by souring acquisitions, Best Buy's stock has taken a dive





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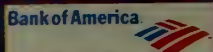
was triple the original estimate. Its profits pushed company earnings just over Wall Street's consensus. That capped a sizzling quarter when Best Buy raised earnings estimates three times, and it sold \$402 million of convertible bonds. It appears, says Charles Mulford, an accounting professor at Georgia Institute of Technology, as if "Best Buy spring-loaded Future Shop's earnings." Jackson calls that assertion "categorically false."

The experts interviewed say Best Buy may have increased Future Shop's liabilities to create reserves for potential restructuring costs. That's fine. But companies aren't allowed to set up excessive reserves, then count ordinary operating expenses as restructuring costs instead of deducting them from earnings. That would inflate profits artificially. The lack of detail leaves open the question that "some of these types of reserves are built into the higher liabilities," says Paul R. Brown, an accounting professor at New York University. Best Buy may also have written down the value of Future Shop's inventory, reducing the cost of the goods it sold and boosting profit margins, say some experts. Asked if the company took excessive restructuring reserves or wrote down inventory to boost profits, Best Buy CFO Jackson says: "Emphatically no."

If the experts are right, Future Shop's apparently meteoric earnings growth may not be sustained, and there could be a writedown, as happened with Musicland and Magnolia. Best Buy says that Future Shop, the No. 1 electronics retailer in Canada, has great promise. Best Buy's Canadian unit—mostly Future Shop—lost 2¢ a share in the fiscal first-half ended Aug. 31 because of consulting fees and costs of new stores, but it should make 4¢ for the full year.

Times are hard for retailers. Investors understand that. Best Buy's fall from grace shows that investors fear they're not getting the whole story. If the company wants to regain its place in the firmament, it will have to tell us more.

Berner covers retailing from Chicago.



Lewis has injected more discipline into the bank's deal-driven culture



BANKING

BOFFO AT BofA

CEO Ken Lewis' hard-nosed approach is paying off

Kenneth D. Lewis didn't wait to be officially named as the successor to Hugh L. McColl Jr. at Bank of America Corp. before serving notice to his colleagues that he was watching their performance very, very carefully. At a Goldman, Sachs & Co. conference in late 2000, Lewis alerted the analysts and investors present that Bank of America was going to take a \$500 million hit from soured loans to one troubled company—which most knew was Sunbeam Corp. Then he surprised his in-house lenders, not to mention the audience, by chiding them for their poor handling of the account. "To

hear him call his own bankers sniveling wimps was pretty stunning," recalls Thomas K. Brown, chief executive of Second Curve Capital LLC, a New York hedge fund.

In his 18 months as chairman and CEO, Lewis, 55, has reshaped the bank's clubby culture to match his own hard-nosed Southern style. As soon as he took control, Lewis began cutting loose roughly \$50 billion of the bank's most unprofitable—and in some cases, riskiest—corporate accounts. The prescient move helped the bank limit the fallout from bad telecom and energy loans. At a time when many big banks are still

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trying to recover, BofA is on track this year to deliver a 15% profit increase, to \$8.5 billion. Its 19% return on equity is 3.5 percentage points higher, and loan charge-offs are lower, than the large-bank average. And its move to boost the quarterly dividend by 4¢, to 64¢, on Oct. 23 was viewed by Wall Street as a sign of Lewis' confidence that the bank's credit problems have peaked.

As a result, the same investors who had lost faith in McColl have rewarded Lewis with a 13% rise in BofA's stock price this year and a 40% jump since McColl formally tapped him in early 2001. By comparison, the Standard & Poor's Bank Stock Index is flat this year and down 6% since early '01. "We're actually proving we can turn the battle-ship around," Lewis says with a smile.

McColl chose a successor who is particularly well suited to the times. McColl valued growth above all else: He transformed his original NCNB Corp. from an also-ran North Carolina bank into the nation's second-largest financial institution, serving roughly 30 million households and two million businesses. But for all his success at dealmaking, McColl never shook off the bank's well-deserved reputation as a chronic underachiever.

Lewis, who has been at the bank his entire working life, earned his reputation as McColl's troubleshooter. He helped oversee the difficult integration of acquisitions in Texas, Florida, and Missouri—and handled the 1998 megamerger with the old San Francisco-based BankAmerica Corp. He brought that same bottom-line approach to his new job: He ousted a number of underperforming executives, instituted a Six Sigma quality-improvement campaign to inject order into the bank's sprawling operations, and overhauled a bonus system that rewarded lenders for simply booking loans. Now, bonuses are largely based on whether an individual generated a 12%-or-better return from their area of responsibility. "Ken is big on discipline. He says repeatedly: 'No excuses,'" notes Edward J. Brown III, BofA's president of corporate banking.

For all of his success, some former executives question whether Lewis can instill the same loyalty among his troops as the gregarious McColl. McColl focused on team-building, and handed out crystal grenades

KENNETH D. LEWIS

BORN Apr. 9, 1947, Meridian, Miss.

EDUCATION BA in business, Georgia State University, 1969.

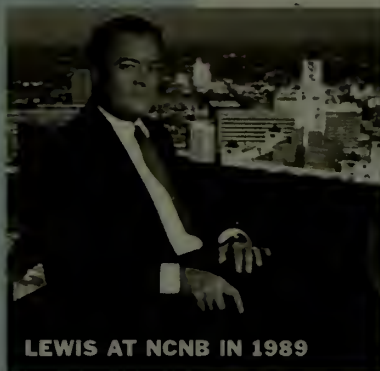
POSITION Chairman and CEO, Bank of America Corp., since April, 2001.

FIRST JOBS Worked after school as a grocery bagger, paperboy, and women's shoe salesman.

CAREER Joined NCNB, BofA's predecessor, out of college as a credit analyst. By age 30 was running the international division. Made his name overseeing integration of acquisitions in Florida, Texas, and elsewhere.

AFTER HOURS After long deriding golf as a "waste of time," has taken up the game and is trying to whittle down his 18 handicap.

FAMILY Divorced in 1978, remarried in 1980 to former bank secretary, Donna; one daughter by first wife.



LEWIS AT NCNB IN 1989

for jobs well done. Lewis is far more reserved. "Ken is the most dispassionate man I've ever met. He has ice water in his veins," says a former exec. A BofA spokesman disputes the characterization, noting that Lewis spends as much time, or more, meeting with employee groups as did McColl.

And if Lewis is taking a more understated approach than McColl, it's by design. Dallas money manager R. Harold Schroeder recalls a 1996 meeting in which Lewis voiced his frustration over the degree to which the Street's visceral dislike of McColl was coloring its views of the bank. "Ken told me: 'At some point, we have to separate the persona of the organization from the persona of the chairman.'"

At the same time, Lewis' internal efforts will take the bank only so far. He's working feverishly to cross-sell more services to BofA's vast customer base and is eyeing a bigger role in asset management, which he hopes to nearly double as a share of revenues and profits, from 7% to 8% now. Analysts say he may eventually need to acquire a Wall Street firm to beef up investment banking. Indeed, sources close to Credit Suisse Group say that Lewis last summer put out feelers to the Swiss financial giant expressing interest in its Credit Suisse First Boston unit, which were rebuffed. Lewis won't

comment on specific talks and downplays expectations that he'll manage a Wall Street deal. "I am highly skeptical that I'll ever think an investment bank is worth what they think it's worth," he says.

Unlike McColl—whose father, a wealthy farmer, pulled a favor with a top bank executive to get him his first job—Lewis has had to make most of his luck. After his parents divorced when he was seven, Lewis helped his mother, a nurse in Columbus, Ga., make ends meet by delivering newspapers, bagging groceries and selling Christmas cards door-to-door. But his toughest job, he admits, was selling women's shoes as a teen. "I made a 6% commission and the most expensive shoes were \$5.99," he says. "You quickly learn how good a salesman you are." After earning a business degree at Georgia State University, Lewis spurned an offer from blue-blood Wachovia Corp. in favor of NCNB. "They were the scrappy underdogs, which is not inconsistent with the way I view myself," he says.

Nicknamed "Kiddle" for both his initials and boy-wonder status, Lewis by age 30 was entrusted with the bank's \$1 billion international department in New York—even as he was taking international banking classes at New York University at night. It was in the late 1980s that Lewis won notice for helping to oversee the delicate integration of failed First RepublicBank Corp. in Texas, McColl's breakout deal.

As CEO, Lewis has already distanced himself from his former boss. If he can keep BofA outperforming its peers, he'll soon be well clear of McColl's shadow.

By Dan Foust in Charlotte, N.C. with David Fairlamb in Frankfurt

"Ken is the most dispassionate man I've ever met," says one former BofA executive. "He has ice water in his veins"

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The bountiful new crop of high-tech goodies

Hot! Hot! Hot!

That's what we think of the new crop of tech goodies in this, our eighth annual Technology Buying Guide. As in the past, our seasoned team of technology pros have unearthed the year's best tech gear. And our reporters and writers have put the products, the software, and services through their paces to ensure that everything works as promised.

This year, though, we've gone one step further and teamed up with CNET Networks Inc. to provide even more depth. CNET, a top supplier of tech information on the Web, has helped us rank and recommend only the best of the lot. You'll find the results, along with thumbnail reviews from CNET, in the tables that accompany each story.

Want more? Once you've digested what we can deliver in this issue, log on to BusinessWeek Online or CNET.com. There you'll find much, much more, including exhaustive reviews of all of the individual products, full specifications, and pricing information that's updated several times a day. It's everything you need to determine what's best for you, and where's best to buy it.

There's a little something here for everyone, but let us point you to some of the highlights. If you're looking for a handheld computer, there are a bunch now that come with a cell phone built-in. Or take a look at the new phones and services: They let you take, send, receive, and store snapshots—all in living color.

We looked at lots of laptops, from lightweight, go-anywhere wonders to mighty behemoths outfitted with CD drives that have the power to burn, baby, burn. Still, you'll get a lot more byte for the buck in

a desktop, be it a bargain-basement home appliance or a megabuck speedster. And with the computer business on the skids, there are great deals to be had. With what you save, you can get a sleek-and-sexy flat-screen monitor to go with it, starting around \$300.

That picture-perfect flat display someday might become the centerpiece of your digital home. Or it might not.

Watch as our reporter rounds up some of this year's most hyped stuff and tries to fashion it into the much-touted wired home. (These days, of course, the wired home is wireless.) In the end, everything worked—most of it ever worked together. Still, this is something you may not want to try at home. Yet.

But there's plenty of tried-and-true here, too. So take a look. You're bound to find some smaller, faster, even smarter gadget or gizmo to simplify your life. And, hey, it may even make it more fun.



A photograph of a person's arm and hand writing the number '5' on a dark chalkboard. The person is wearing a white shirt. The text 'Chalk to board.' is visible in the upper right corner of the image.

Brush to canvas.



Pencil to paper.



ANNUAL TECH BUYING GUIDE

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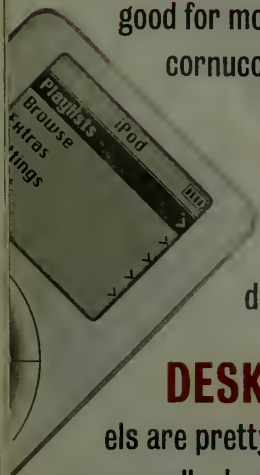
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DIGITAL PHOTOGRAPHY170 Cameras for every need, every budget—and, best of all, every level of tech competency

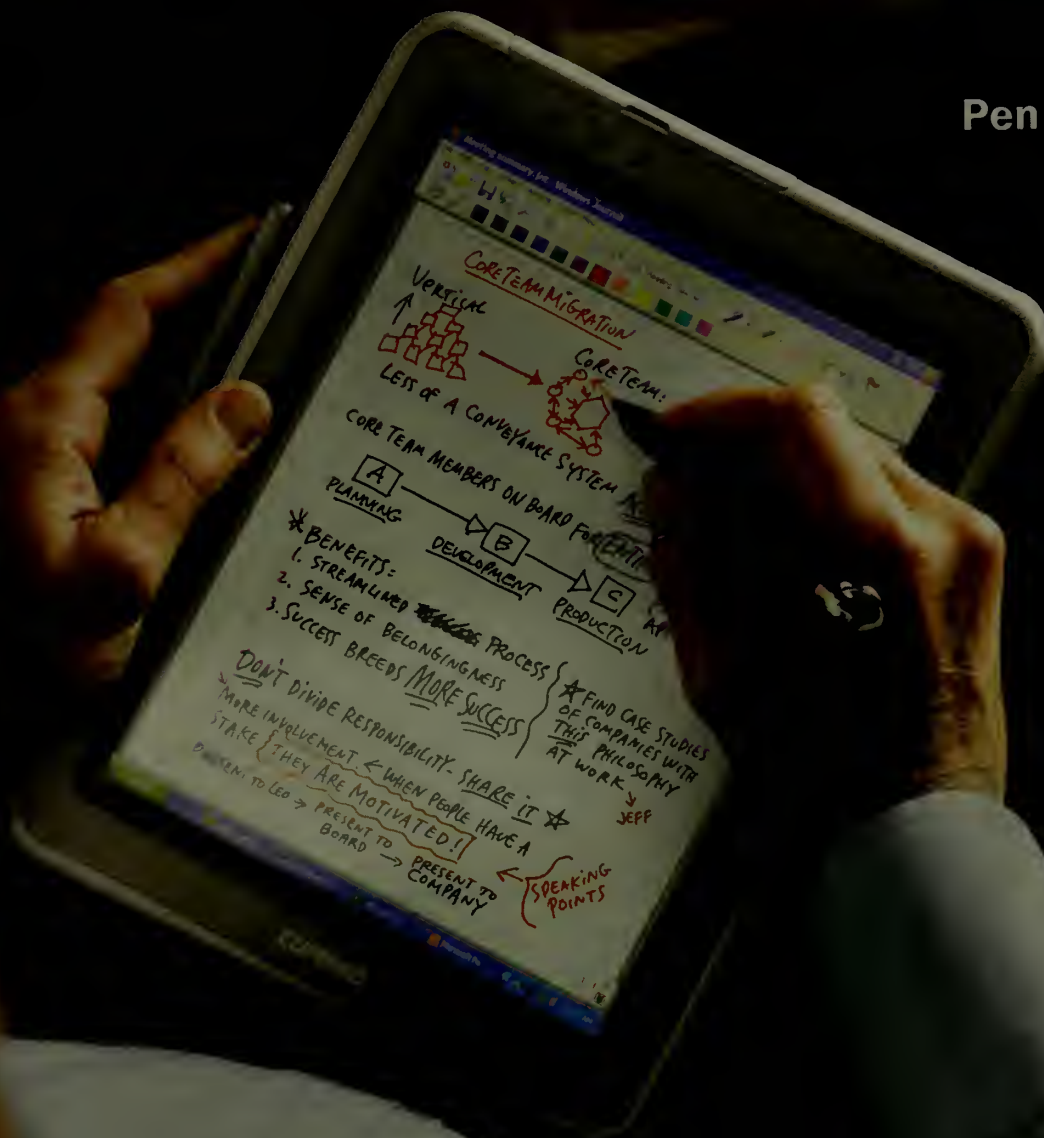


Product rankings and reviews are from CNET.com

BusinessWeek online

Additional products and updated information can be found at www.businessweek.com/ebiz/

Pen to screen.



Introducing the Tablet PC.

The full power of a PC, the freedom of pen and paper.

Now the freedom of writing and drawing meets the amazing power of the notebook PC, and something greater than either is born, the Tablet PC. It's all the power of Windows® XP in a package you use like a notebook computer or with a flip of the screen, like a simple pen and pad of paper. Only it's a digital pen and pad, so you're marking up web articles,

jotting notes on PowerPoint® slides, highlighting key points in a Word document, even creating and sending e-mails in your own handwriting. Whether you're in your office, in a meeting, in the hallway or in a cab—the Tablet PC is the PC more mobile, versatile, and powerful than ever before. For more information, visit microsoft.com/tabletpc



On your desk.



On your lap.



In your hand.



Big Tigger really didn't see much reason to have a handheld computer. He used phones, PCs, and a Motorola two-way pager to stay in touch with friends, family, and colleagues at Black Entertainment Television in Washington, D.C., where he hosts the popular *Rap City: Tha Bassment* music show. A PDA like a Palm or a Pocket PC just didn't cut it, says the 29-year-old entertainer. Palms or IPAQs were fine for investment bankers, but not for music mavens.

Not any more. Last summer, Big Tigger first caught sight of the T-Mobile Sidekick. One of a growing breed of handheld computer-phone combos, the slick Sidekick has a screen that rotates to reveal a keyboard for sending e-mail and instant messages. A couple of months later, Big Tigger got the Sidekick (\$200 with activation from T-Mobile, plus voice and data service at \$35 a month). Now he carries it everywhere, using it to zap quick e-mails and chat on the phone. And when he flashes the little machine, it causes a big stir.

"People have even tried to buy it off me," Big Tigger says.

As if they couldn't find them at the mall! But before dashing out the door to snap up one of your own, consider this warning: The new hybrid voice and data communicators may pack a lot into them, but there's no single device that does everything really well. Each one is missing a feature, whether it's a color screen, an integrated phone, or a

keyboard. That means that even when you pony up for a dream handset, you have to come to terms with wrenching trade-offs.

How to decide what you need, and what you can do without? Here are some guidelines:

Let's say you're a gadget lover, with a tiny cell phone, a PDA digitally stuffed with data from life and work, and an MP3 player. Maybe you even shuttle e-mails on a BlackBerry. People like you

were born for smart phones, hybrids that offer just about everything.

Start with the Sidekick. Aimed at 18- to 34-year-olds, the Sidekick has lots of flash, plenty of substance, and doesn't break the bank. Its rotating screen gives it a big wow factor while being remarkably practical. Messaging is a snap. For calls, just hit a button, and the Sidekick's speed dial takes over. The device also boasts buttons and roll bars that flash

when e-mails and calls come in. Its cool, digitized ring tones sound like the Tribbles meeting *The Matrix*.

For all its fun, the Sidekick's a bit of a slacker at work. The e-mail isn't connected to corporate networks yet. And it can't synchronize with popular PC calendar and contact software, such as Microsoft's Outlook. Even Big Tigger wishes the device had a color screen and better Web-browsing capability. "If they took care of a couple of things, it would be perfect," he says.

For regular working stiffs, two smart phones in opposite camps stand out. The \$549 T-Mobile Pocket PC Phone Edition (along with similar designs from AT&T Wireless and mmO2 in Europe) is the first handheld in the U.S. to use Microsoft's phone software. The Treo 300, at \$449 with a \$50 rebate from Sprint, is the latest in Handspring's lineup of Palm-based devices.

Both handsets deliver as phones. They're wider and longer than most cell phones, but are still slender

Let's Have a Big Hand for the New Hand

Now you can e-mail, surf, and phone with a PDA, but peruse the field before you choose



melds

enough to slip into a pocket. Their sound is crystal clear, and speed-dialing from the address book is a breeze. Careful, though. Unlike a regular cell phone that you charge once every several days, these Web-surfers devour batteries. They'll likely need a charge every night.

For writing, the Treo's a better bet—assuming you know how to type. Its thumb keyboard may look too tiny for serious e-mailing, but it's surprisingly effective. By comparison, the touch screen of the Pocket PC is cumbersome even for short messages. You either hunt and peck the digital keys on the screen or write, letter by letter, with the Graffiti handwriting-recognition system.

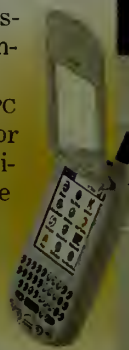
Al Roker, co-host of NBC's *The Today Show*, opted for the Treo 300. He counts on it for sending e-mails and surfing the Web. "Just last month, I had a flight to Cleveland canceled," he says. "I used [the browser] to go to Expedia.com and check other flights. It has enough of everything I need to get through my day."

The Pocket PC does have its pluses. Without a built-in keyboard, it has room for a bigger screen. The display is brighter and crisper, and it is easier to read in bright daylight. What's more, the Pocket PC phone synchronizes easily with the Microsoft programs on your PC. The newest update of Microsoft's Media Player for the desktop, for instance, has an easy-to-use option for copying music files from a PC to the handheld, which moonlights as a personal stereo.

Many want such convenience. The question is whether it should all be in the same machine. Assume you've got a favorite cell phone. The battery lasts forever, and it fits into that little square bluejean pocket. Does it make sense to shelve it for a much larger smart phone? If the answer is no, then you're in the market for one of the top-of-the-line

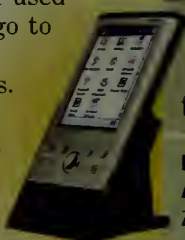
PDAs that accompanies a phone, but doesn't try to supplant it. Don't worry, you'll still be able to book flights and suss out driving directions on the move: The small phone will send signals to these phoneless PDAs through wireless connections, such as Bluetooth, a low-frequency radio signal that links devices that are up to 30 feet from each other.

The Toshiba e740, which can cost anywhere from \$379 to \$599, boasts wireless communications, but without a phone. It manages this through a built-in wireless technology called Wi-Fi. That works for checking e-mail, prowling the Web, sending instant messages in the office—or using so-called wireless access areas in hotels, air-



IT'S A HANDHELD... IT'S A PHONE

MODEL/ WEB SITE	PRICE	FAMILY/ SCREEN	THE GOOD, THE BAD, THE BOTTOM LINE
HANDSPRING TREO 300 handspring.com	\$499 to \$549	Palm/ Color	Compelling flip phone sounds crystal-clear, and the built-in keyboard eases Web navigation and e-mail. Still, it's costly.
T-MOBILE POCKET PC PHONE EDITION t-mobile.com	549	Pocket PC/ Color	First U.S. PDA phone with Microsoft's new Pocket PC phone software. Call quality is clear; screen is sharp. But surfing the Web is slow and can't be done while using the phone.
T-MOBILE SIDEKICK t-mobile.com	199 with a 39.99 monthly plan	Proprietary/ Monochrome	It has a 2.5-inch screen that rotates to reveal a nifty keyboard. Offers e-mail and great instant-messaging, although battery life is mediocre.



TOP OF THE LINE HANDHELD

TOSHIBA POCKET PC E740 toshiba.com	379 to 599	Pocket PC/ Color	Built-in Wi-Fi makes wireless Web connections a snap, and it has dual slots for expansion cards. But you only get two hours of battery life in wireless mode.
RAZOR ZAYO A600 zayotech.com	499	Pocket PC/ Color	This handheld is zippy, with flashing blue lights under the buttons. It's slim, lightweight, and fast. Its software, though, sticks just to the basics.
SONY CLIE PEG-SJ30 sonystyle.com	269 to 299	Palm/ Color	It fits in a pocket and comes with rechargeable, replaceable batteries. Sharp display and software make it good for viewing and editing snapshots.



EASIER ON THE POCKETBOOK

PALM m130 palm.com	206 to 249	Palm/ Color	It's easier to read than monochrome models, though it fades in bright sunlight. Comes with connectors and software of more expensive Palms
ZIRE palm.com	99	Palm/ Monochrome	No-frills handheld dishes up just the basics—calendar, address book, to-do list, calculator. Only 2 MB of memory and no expansion slot, though.
SONY CLIE PEG-SJ20 sonystyle.com	165 to 199	Palm/ Monochrome	Offers function over fun. Stripped-down version of Sony's SJ30, this one with monochrome screen. Outstanding value for the truly budget-conscious.

Data: CNET.com

For more choices, visit businessweek.com



What to look for in a photo printer.

No borders.

Want the freedom to print beautiful, borderless photos without going to a photo lab? Take a look at the all-new line of Canon printers. You can take digital images and print out 4" x 6" borderless photos in about 47 seconds.** You can also print stunning 8 1/2" x 11" edge-to-edge, borderless photos.† And with the Canon Easy-PhotoPrint software that comes with all our printers, it's never been easier to crop, rotate, resize and print your photos.†† So go ahead and start printing. There are no borders anymore.

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ports, or coffeehouses. But don't forget the recharger. The e740 will run for only about two hours with Wi-Fi turned on. For serious Web-surfers, it might make sense to spend \$129 for an auxiliary battery.

When it comes to pure power, Pocket PCs reign supreme. The e740 is leading the switch to Intel Corp.'s speedy xScale processor. The device has 64 megabytes of RAM, and you can add more by slipping a memory card into a slot. That offers plenty of room for addresses and calendar entries, as well as for Word, Excel, or PowerPoint documents, videos, or music.

Feeling artistic? With Palm's new \$499 Tungsten T, you can draw notes or sketches on the square screen and zap them to friends in the next room, or colleagues across the meeting table. The connection comes from Bluetooth. If your phone has Bluetooth, you can meander through the Web on the Tungsten, using the phone as the modem. One warning though: Coaxing two Bluetooth devices to communicate with each other can tax the patience of even the hardest do-it-yourselfer. If the store offers help in setting up the connection, don't hesitate to grab it.

The \$499 Razor Zayo

A600 is another strong Pocket PC contender. At half an inch thick, it barely bulges in a jacket pocket. And yet it's as zippy as the scooters Razor sells. It has the same processor and memory as the Toshiba. But you can set it on battery-saving mode when working on e-mails or the calendar. For higher-energy apps, like videos or music, it kicks into overdrive. After about three hours of music, though, the battery dies out.

The Palm-based Sony Clie PEG-SJ30 is no slacker. With a color screen and expandable memory, this hardworking, mid-tier device is affordably priced at \$299. It's lightweight, small enough to slip into any pocket, and easily handles address and calendar tasks. Its slow processor, though, struggles to handle video and multimedia games. Still, the high-resolution screen is great for handling still images, and you can edit the pictures using Sony's Clie Paint program.

Amid all these devices, lots of folks still swear by



HOOKED TV host Big Tigger takes his T-Mobile Sidekick everywhere. "People have even tried to buy it off me"

paper calendars and notebooks jammed into a back pocket. But with a host of affordable machines pouring into the market, it might be time even for skeptics to make the digital leap. The Palm Zire is a good starter PDA. It's sleek and boasts all the essentials—calendar, to-do list, calculator, and address book—in a no-frills package. But it only has 2 MB of memory, a humble 16-MHz processor, and a monochrome screen. Palm scrapped the sync cradles and custom cables of older

models. The Zire connects to a computer with a standard USB cable and comes with a charging cable.

For a step up among low-cost models, check out the Sony Clie PEG-SJ20 and the Palm m130. Both have substantially more memory and processing power than the Zire. They also have slots that can be used for memory expansion or to load programs and reference materials, such as restaurant guides. At \$249, the m130 costs about \$50 more than the SJ20, but unlike the SJ20 it sports a color screen.

Not long ago, the industry was hunting for the miracle machine, a handheld that would combine the phone, the PDA, even the MP3 player. Now we're seeing not just one device, but an explosion of tantalizing choices. And as this wild new industry blossoms, the choices aren't going to get any easier.

By Heather Green



MO'HOTSTUFF

THE POD

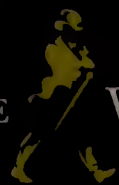
\$50/RoadWired/roadwired.com

>> Whoa! Last I counted, this smart little cube of a bag had 20 pockets and pigeonholes, or was it 22? Not to mention Velcro dividers to keep your handheld from banging into your camera in the roomy main compartment. And there's all manner of elastic and bungee cord to stow spare batteries or secure unruly charger cords. It has easy-to-get-to outside mesh for cell phones and lens caps, and even one pocket that's secret.



IT'S SIMPLE. DECIDE WHAT YOU WANT, TAKE THE WORLD.
WHATEVER YOUR DREAM. KEEP WALKING.

JOHNNIE WALKER



Untangle Your Wireless Options

The long-hyped technology is finally at hand. Here's how to choose the right stuff

This is a good time to be a cell-phone customer. Six national companies in the U.S. are battling for market share, offering hundreds of minutes at bargain rates, and practically giving away calls on evenings and weekends. And lots of the new phones have color screens.

Who cares about color on a phone? Many pooh-pooh it. But when Ericsson launched its color-screened T68 in Europe a year ago, madness ensued. Color-crazed con-

sumers waited in long lines for the phones.

Color, it appears, sells. It's especially appealing to people who play games on their handsets. And the T68i, now offered by Sony Ericsson, gives you a U.S. version of Europe's phenomenon. The little tri-band phone can operate in much of the world (minus Japan) and is a gadget lover's dream. Its Bluetooth technology can transmit to a wireless headset. So, if you can pry your eyes from the color screen, you can make calls without even taking



the handset out of your purse or briefcase. The T68i sells for \$150, when included in a subscription.

Not your style? Maybe you're an economy buyer, someone who wants the convenience of mobile communication—without wading through manuals or receiving eye-popping phone bills every month.

Or perhaps you're a business user, like Kelly Smith, a 34-year-old self-employed software dealer in Seattle. He spends \$59.99 a month for 1,500 minutes, plus free weekends and nights, on AT&T Wireless. "I hardly ever use my home phone anymore," he says. Smith spends an extra \$7.99 for a mobile Net service, and checks his e-mail on his Sony-

Ericsson T68i.

Let's say you're an economy buyer. The first thing to do is shop for a network, not a phone. Ask neighbors which company they use. The key is to find a service

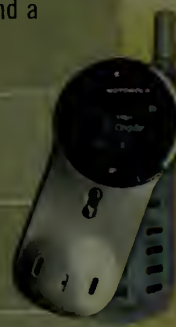
A FEAST OF HANDSETS

A new generation of cell phones with color screens, always-on Internet access, and games:

PRODUCT/WEB SITE	PRICE	SIZE	THE GOOD, THE BAD, THE BOTTOM LINE
SONY ERICSSON T68i sonyericsson.com	\$150	3.9 x 1.9 in./ 2.9 oz.	Loaded with cutting-edge features and a color screen, but the keys are tiny.
SAMSUNG SPH A500 samsung.com	250	3.4 x 2 in./ 3.56 oz.	Stylish design, sharp color screen, and lots of features, but battery poops out quickly.
MOTOROLA V70 motorola.com	175 to 350	3.7 x 1.9 in./ 2.9 oz.	Great design, good battery life, but not the most feature-rich. And it's no bargain.
SIEMENS S46 siemens.com	99	4.6 x 1.7 in./ 4.3 oz.	Good for biz users, thanks to strong battery, Net access, and world roaming. A bit heavy.
NOKIA 6310i nokia.com	150 to 200	5.1 x 8 in./ 3.9 oz.	With a powerful battery and fast Internet access, it's a good choice for business, but also weighty.

*Prices, which are set by carriers and often change with promotional offers and rebates, may vary.
Data: CNET.com

For more choices, visit www.businessweek.com





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At Fannie Mae, our job is to lower costs to save home buyers money.

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You see, at Fannie Mae, everything we do is in the pursuit of one goal — making the American Dream an affordable dream.

that provides good coverage where you live and work. This is a matter of economics. If your mobile phone works well at home, you can switch to the cell for your long-distance calls. They're free, as long as you stay within your monthly minutes. For low rates, you might consider T-Mobile. One \$39.99 plan offers 100 anytime minutes and unlimited weekend talk.

Once you pick up the phone and go to the phone's speed-dial something counter. Buy gobs of minutes. Here's why: In the U.S., you pay for calls you make and receive. And when you top your limit, the phone companies nail you for extra fees. If, for example, you sign up for Verizon's bargain 300-minute plan but end up speaking 550 minutes, extra charges drive your bill from \$39.99 to \$152.49—lots more than the \$54.99 you pay for the 550-minute plan.

For gadget lovers, the Samsung SPH-A500, available at Sprint PCS, provides a



MO'HOTSTUFF

FREESPEAK BLUETOOTH HEADSET

\$100/Jabra Corp./jabra.com

>> This sleek silver-and-black headset, with its tiny boom microphone, curves around the back of your ear, and the day-glo gel speaker tip pivots so you can use it in either ear. Better yet, there's no wire: It's designed to go with Bluetooth-equipped phones. No Bluetooth phone? For \$80 more, Jabra makes a version with the Bluetooth radio technology built into an adapter/charger. Just plug it into your phone's headset jack, and you're ready to go.

heap of handset in a small package. Its color screen is sharper than the SonyEricsson, perfect for downloading games. And Sprint PCS's new Net service, which costs \$10 a month, provides unlimited megabits of data.

Techies will find plenty to like in a host of new phones loaded with pioneering features. Among the hottest is multimedia messaging services, or MMS. Until now, wireless phones could only receive digital photos from

other callers as e-mail attachments; MMS allows people to snap and send photos from one multimedia phone to another.

The \$199 Motorola Inc. T720i, unveiled in October, is among the slickest of the breed. It features a large color screen, great for multiplayer Internet games.

Tired of lugging around a laptop? Phone companies are offering lots of bargains for full-featured smartphones. In late October,

Sprint PCS announced a special package for data glut-tions. For \$499 to \$599, you buy a Handspring Treo 300. For \$95 per month, you get 2,000 anytime minutes, unlimited nights and weekends—and unlimited data. Pig out!

After years of hype, wireless services have arrived. Who knows? With all these new features, maybe even economy users will start dabbling in mobile data.

By Steve Rosenbus

MAKING SENSE OF WIRELESS

Choosing a wireless phone service can be confusing. Here's a look at what you get—and what you don't—for \$40 a month:

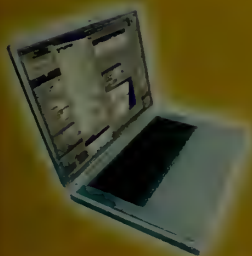
COMPANY	INCLUDED	EXTRA	THE GOOD, THE BAD, THE BOTTOM LINE
AT&T WIRELESS	500 anytime minutes. New deal gives extra 500 minutes.	Additional calls are 20¢ a minute. Internet service starts at \$6.99 in most markets for 1 megabit of downloads.	AT&T gets the highest ranking in the J.D. Power customer-satisfaction survey.
CINGULAR	450 anytime minutes, 3,000 night and weekend minutes.	Additional minutes cost 45¢. Net access starts at \$6.99.	Prices are average. Customer satisfaction ranks third.
NEXTEL	300 minutes, with no roaming charges, plus 3,600 night and weekend minutes.	Additional minutes are 35¢ each. Net access starts at \$3.50. Unlimited two-way messaging costs \$7.50.	Two-way radio service is popular at work. For Net access, it's about half as fast as most other carriers.
SPRINT PCS	400 anytime minutes, unlimited night and weekend minutes.	Additional minutes cost 40¢ each. Unlimited data is \$10 for most plans.	New price plans make it competitive. Good on games.
T-MOBILE	600 anytime minutes without roaming charges. 50 inbound text messages.	Additional voice minutes are 40¢. Net service starts at \$2.99 for 1 megabit. Wi-Fi service starts at \$29.99.	Good prices and a host of features, such as Wi-Fi and international roaming.
VERIZON WIRELESS	300 anytime minutes and bargains on calls to other Verizon wireless phones.	Additional voice minutes cost 45¢. If you venture off Verizon's network, you can pay 69¢ a minute.	Verizon rates second in the J.D. Power customer-satisfaction survey. Coverage is extensive but pricey.

Data: BusinessWeek, company reports

For more choices, visit www.businessweek.com

where

do meetings go when there aren't
conference rooms available?



With just a phone and a pc, you can now present to thousands of people anywhere in the world. Eliminate travel, drastically reduce costs and find all the meeting space you need by using PlaceWare. Find out more at placeware.com/bw where right now you can take advantage of a 15-day free trial (over \$1,000 value). Meet. Train. Present. Right from your computer.



PLACEWARE®
Log in. And meet.

www.placeware.com/bw

Information, Please

With these cell-phone extras, you can get everything from traffic reports to games

Brian Murphy gets his daily business headlines and weather forecasts simply by turning on his cellular phone. No calling or log-on needed.

It's all in a text message sent to him by Pronto, a subscription service that provides information on the fly to mobile-phone users. Murphy, a trader at KBC Financial Products in New York, also dials Pronto's toll-free number when he needs restaurant reservations or driving directions. "They can answer any question," he says.

If you think your cell phone is only good for gabbing, it's time to take another look. A growing selection of cell-phone extras can turn your run-of-the-mill handset into everything from a personal concierge to a fully stocked game room. And you don't even have to launch your phone's Web browser to use them. Some, like Pronto, take advantage of text-messaging to deliver info right to any cell phone.

Others are software programs that you can download into your phone wirelessly simply by clicking through the choices offered by your wireless carrier.

The smorgasbord of downloads varies by carrier, as does the pricing. Some carriers charge a one-time fee for unlimited use of the software. Others charge you to use the game or program for a set amount of time, after which your access to it is blocked. The game JAMDAT Bowling, for example, costs \$1.99 a month or \$4.99 for unlimited use on Verizon Wireless's Get It Now download service. On Sprint Corp.'s PCS Vision, you'll pay \$3.99 for 60 days of use.

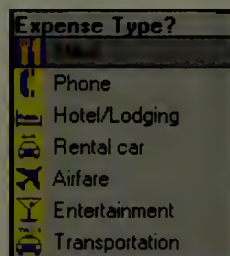
Some of the best downloads turn your phone into a travel assistant. With Air-Info, available from Verizon, for example, you can check the status of a flight by punching your flight number into your phone. The same service clues you in to general travel conditions at specific airports. Another of-

fering, Mobile Expense, allows you to punch in restaurant bills or taxi fares and send them through a short message to the expense form on your PC.

Some of the most useful

forth—on the Web (askpronto.com), Pronto sends text alerts to your phone, tailored to your preferences. The cost: \$19.95 per month.

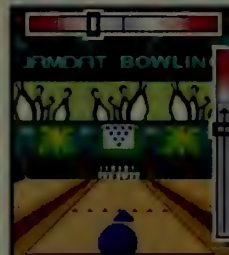
For drivers, the My Car service from MSN Autos



MOBILE EXPENSE
verizonwireless.com

\$1.25 a month

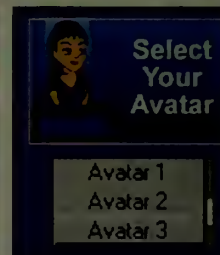
Helps Verizon customers keep track of their schmoozing costs—whether they're at home or on the road



JAMDAT BOWLING
jamdatgames.com

Price varies

Tricky throws from the keypad make for lots of gutter balls in this addictive game



JEOPARDY!
verizonwireless.com

\$2.50 a month
This scaled-down version of the TV quiz-show fun provides hours of fun, complete with features such as the Daily Double

cell-phone tools are available to all, regardless of their wireless carrier. Pronto is one of the best. Once you set up your preferences—weather, stock quotes, and so

(autos.msn.com) is handy. You can set it to send traffic alerts to your phone in 65 cities. Fees? You just pay your carrier for the short messages, according to the details of your phone-subscription plan.

Done working? It's time to have some fun. Depending on your mobile operator you can download dozens of games, from classics such as Jeopardy to Tiger Woods PGA Tour.

Sometimes it's a bit tricky, to say, aim and shoot a ball using the number keys, but once you get the hang of it, you could get hooked. And you'll soon forget the days when your cell phone was a talk and no action.

By Arlene Weintraub



MO'HOTSTUFF

SHOUT MESSENGER

\$6.99 a mo./Eyematic/www.eyematic.com

>>> Why send a boring text message to tell a friend about that great new job when you can get the Incredible Hulk to deliver the news instead? That's the idea behind Shout Messenger, a new service from Verizon Communications that allows subscribers to attach full-color animated characters to text messages. Type your message, then pick a Marvel superhero to deliver it, along with the appropriate emotional response. Come on, Hulk. Smile!

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They Work Hard, Play Hard—On Your Knee. They're the

Latest Laptops

And because they're so capable, they raise a question: Dare I ditch my desktop?

For years, tech gurus have envisioned a day when a gaggle of digital gadgets will run our lives. Our PCs, cell phones, handhelds, TVs—even our kitchen appliances—will all seamlessly link up to handle the details of daily existence. But while the world waits for third-generation phones, tablet PCs, and Web-enabled refrigerators to deliver on their potential, there's a machine that already does much of what the future promises: the tried-and-true laptop.

Today's laptops have enough brains and brawn to be your only PC. Processors running faster than 1 gigahertz are standard fare on even stripped-down models costing \$1,200 or less. So are eye-pleasing screens, lightning-fast CD burners, spacious hard drives, and enough memory to make an elephant proud. Packed with power, portables now deftly handle even the flashy games and demanding multimedia work once reserved for deskbound giants.

The best reason to ditch your desktop, though, is wireless. Setting up a wireless network at home now costs less than \$150—which means you can get rid of all of those cables and surf from anywhere in the house. And public wireless access points—using a technology called Wi-Fi—are sprouting up in airports, hotels, coffee shops, and parks to give lap-

top luggers untethered access to the Internet at speeds cell phones won't touch anytime soon.

These days, you can get a decent laptop for less than \$1,000. But if you're banishing your only desktop to the attic, you'll likely want to pay a bit more to get the right balance of screen size, battery power, and processor performance. If you want

Wi-Fi, you might choose a model with a built-in antenna—an option costing about \$50 to \$100. The lightest machines, ultraportables, aren't much bulkier than a glossy fashion magazine. If you want everything but the kitchen sink, try a desktop replacement. You can lug it around the house or to the backyard—although probably not much farther than

that. Die-hard business travelers, meanwhile, usually prefer midprice “road warriors,” which offer excellent performance and a mix of features in a manageable size.

Even the lightest machines can handle the most demanding tasks. Our top ultraportable pick, Dell Computer's \$1,978 Latitude C400, weighs in at 3.6 pounds. It comes with a 1.2 GHz Pentium III-M chip—the “M” stands for mobile—256 MB of RAM, and a 30 GB hard drive. Compaq Computer's Evo N410c tips the scales at just 3.5 lb. and offers a nifty \$199 expansion module allowing you to use up to four batteries at a time. Even lighter are the waifish Toshiba Portégé 2000 and Sony VAIO SRX99—both weighing less than 3 lb.

The problem with many flyweights is that their batteries won't last much longer than a subway ride, let alone a transatlantic flight. Not so the IBM

tops





ThinkPad X30: the \$2,500 machine can go four hours without being plugged in. Add a 1-lb. second battery, and it'll last eight. Either way, it's light enough for law student Aaron J. Schechter to tote to class every day at Boston College Law School. And since BC is one of a growing number of campuses with a Wi-Fi network, Schechter can spend a sunny day digging up precedents

out on the lawn, not holed up in the library.

You don't have to be a mobile maven to crave a laptop as your main PC. Among consumers, the best-selling portables are, in fact, desktop replacement models such as the top-ranked Dell Inspiron 8200. These incredible hulks can do nearly everything traditional PCs do, but they take up a fraction of the space. Chris R. Davis,

a risk analyst for online bill service CheckFree Corp., chucked his desktop for a \$2,658 Gateway 600xl. At 8.7 lb., the 600xl isn't very portable, but its 2-GHz processor is plenty powerful for burning CDs and watching DVDs on its sprawling 15.7-inch screen.

If money is no object, take a look at the Apple PowerBook G4. At 5.4 lb., the machine, costing roughly

\$3,000, is light enough to be Lee L. Schissler's mobile office and powerful enough to be his production studio. Before pitching a client on a \$50 million project recently, the Houston marketing consultant edited video clips and wove them into a professional presentation stored on his 40-GB hard drive. Laptops are now so capable, "you can carry your life on them," Schissler says.

Yet for all their tantalizing features, fully loaded

laptops are impractical for hard-core business travelers. Midprice, midsize machines are still the most popular

for the corporate set. The gold standard:

IBM's ThinkPad T30, our top pick in the category. Its staid black case isn't flashy, but it gets kudos for durability. And the little touches Big Blue throws in have made it a favorite with mobile managers: There's a tiny night-light above the keyboard, for instance, and dual antennae for better Wi-Fi reception.

Practical doesn't have to mean boring. Toshiba's Portégé 4010, which starts at just \$1,599 for a 933-MHz Pentium III-M chip and 256 MB of RAM, features a distinctive silver case and a host of goodies like a FireWire port for downloading digital video and a slot for plugging in cards that fit into MP3 players and digital cameras. The best part: It weighs a mere 4.2 lb.

As wireless networks proliferate, the popularity of do-everything laptops should soar. Just ask Miami Internet entrepreneur Marc Fest. With his ultralight IBM X30 and Wi-Fi, he often works from a beachfront café. Sure beats an Internet refrigerator.

By Andrew Park



ULTRAPORTABLES

PRODUCT/ WEB SITE	PRICE	SPECS	THE GOOD, THE BAD, THE BOTTOM LINE
DELL LATITUDE C400 dell.com	\$1,978	Pentium III-M, 1.2 GHz, 256 MB RAM, 30-GB hard drive, 12.1-in. display, 3.6 lb.	It packs lots of power into a portable package, but its battery won't win awards.
COMPAQ EVO N410C hp.com	\$2,010- \$2,130	Pentium III-M, 1.2 GHz, 256 MB RAM, 30-GB hard drive, 12.1-in. display, 3.5 lb.	Easy on the shoulders, but an average keyboard. Its decent battery can be boosted with a Mobile Expansion Unit.
IBM THINKPAD X30 ibm.com	\$2,320- \$2,507	Pentium III-M, 1.2 GHz, 256 MB RAM, 40-GB hard drive, 12.1-in. display, 3.7 lb.	Add a second battery, and you'll get eight hours of use. But if the screen is dim, blame the cheap graphics card.

ROAD WARRIORS

IBM THINKPAD T30 ibm.com	\$2,049- \$2,814	Pentium 4-M, 1.8 GHz, 256 MB RAM, 40-GB hard drive, 14.1-in. display, 5.7 lb.	Dowdy but durable, it's the gold standard for biz travelers. A nifty night-light lets you work in the dark.
DELL LATITUDE C640 dell.com	\$2,229	Pentium 4-M, 2.0 GHz, 256 MB RAM, 30-GB hard drive, 14.1-in. display, 5.5 lb.	Corporate workhorse with blazing speed and generous battery life. But Dell skimped on ports for peripherals.
TOSHIBA PORTEGE 4010 toshiba.com	\$1,599- \$2,284	Pentium III-M, 933 MHz, 256 MB RAM, 30-GB hard drive, 12.1-in. display, 4.2 lb.	Not much heavier than an ultraportable, with fun multimedia features. The trade-off: a small display.

DESKTOP REPLACEMENTS

DELL INSPIRON 8200 dell.com	\$2,112	Pentium 4-M, 2.0 GHz, 384 MB RAM, 30-GB hard drive, 15-in. display, 7.9 lb.	Speed to spare and multimedia power usually reserved for desktops. The downside: its hefty weight.
APPLE POWERBOOK G4 apple.com	\$2,875- \$3,299	PowerPC G4, 800 MHz, 512 MB RAM, 40-GB hard drive, 15.2-in. display, 5.4 lb.	Sleek design and wide screen might make you chuck your Windows PC. But ouch! The price.
GATEWAY 600XL gateway.com	\$2,658	Pentium 4-M, 2.0 GHz, 512 MB RAM, 40-GB hard drive, 15.7-in. display, 8.7 lb.	A maxed-out machine with a huge screen and lots of room to expand—if you can lift it.

Data: CNET.com

For more choices, visit businessweek.com

A woman with blonde hair, wearing a white tank top and light-colored pants, is sitting on a wooden deck. She is leaning forward, working on a laptop. The deck is made of reddish-brown wooden planks. In the background, there is a white railing and a large, stylized globe showing the Americas. The scene is set outdoors, with a clear blue sky and some greenery visible in the distance.

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Desktops That Deliver

From movie editing to network nerve center, they do plenty of heavy lifting

Make no mistake, in the age of Internet mobility, desktop computers are the ugly stepchildren of notebooks. Now, following the lead of Apple Computer and its wildly popular iMac flat-panel computer, PC makers from Gateway and Dell to Hewlett-Packard and Sony are gussying up the dowdy PC with special features and flashy designs.

With offerings for everyone from the sleep-deprived gamer to the work-obsessed administrator, desktop suppliers are straining to create a little buzz that will bring in new buyers. In the opinion of Peter Hamel, a VerizonWireless customer-service supervisor, the effort is paying off. When Hamel isn't flying down the roads in his Honda S2000 sports car, he's at home, moving at warp speed around the Web or playing games in overdrive with his Falcon Mach V Exotix desktop. It's loaded with a 2.4-gigahertz Intel Pentium 4 processor, 1 gigabyte of memory, dual 40 GB hard drives, and a high-resolution monitor. It also sports the latest powerful Nvidia GeForce graphics processor—a key feature on desktops that makes games like War Craft III look more

realistic than the computer renderings in the movie *Toy Story 2*.

The machine from Falcon Northwest, a specialty PC maker, stands out for another reason: Its case shines with the same “Berlina Black” finish as Hamel's Honda. Falcon offers customers the option of painting a PC's case in automotive finishes, in any color or design, for an additional \$400. Prices for a complete system vary—but none is low. Hamel didn't blink at paying \$4,895. As he puts it: “Ferrari doesn't have a discount model, does it?”

Fear not, penny-pinchers. There are still plenty of spiffy mid-range PCs out there for people on a Saturn budget. Last January, Apple reminded the industry that style counts when it released the eye-catching iMac, currently priced from \$1,199 to \$1,999. Gateway responded with its Profile 4, retailing from \$999 to \$1,999. Like the iMac, the Windows-based Profile showcases a liquid-crystal display, but the screen's casing contains disk drives,

processor, and other paraphernalia. And in September, Sony unveiled a \$1,500 VAIO PVC-W10 widescreen desktop with a stowaway keyboard that flips up to provide extra space when you're not working.

Even PCs on the cheap can do an owner proud. At less than \$1,000, PCs from Dell and HP provide decent processing power for today's business applications. At \$899, the iBuyPower Value XP PC also is a great buy, although it lacks some of the frills of higher-priced

models, such as networking cards for high-speed Internet access.

To put more people in a buying mood, technology advancements in desktops are coming fast and furious. PCs are being used to record and store TV shows. They're becoming the brains of home networks. And they're turning into virtual music and film studios. Good software helps, but the hardware also has drastically improved. A year ago, the most powerful desktop topped out at 1.8 GHz. Chipmaker Intel on



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COMMUNICATIONS

Nov. 14 is expected to release a Pentium 4 chip that inches past the 3 GHz barrier, making it easier for PCs to run several heavy-duty programs at once.

The trick is balancing price against benefits, says San Francisco attorney Todd Norris. In September, he discovered after buying a new digital camera that he needed to replace his wheezy HP Pavilion, which ran at a turtle-like 233 MHz. Norris listened politely while a sales representative droned on about the bells and whistles on an expensive Sony model. Then he settled on an HP Pavilion with a 2.4-GHz Pentium 4 chip for \$1,800. "I wanted a computer that can download



MO'HOTSTUFF

ARCHOS TECHNOLOGIES

\$450/Archos Jukebox Multimedia 20/archos.com

>> You thought the iPod was cool? Take a gander at the Archos Jukebox Multimedia 20. A jack of all trades, this palm-size gizmo stores thousands of songs and has a 1.5-inch LCD screen that displays digital photos. What's more, you can download movies and other video from your PC to play back while you're on the go.

screens and data quickly. And I got it at what I thought was a reasonable price," Norris says.

Price aside, it's important to sort out what uses you'll have for a desktop. Major manufacturers, including

Dell, HP, Apple, and Gateway, typically include a rewriteable CD drive that allows you to burn music disks for your car or portable player. This is possible even with low-end models like the \$549 HP Pre-

sario, which sports an Athlon XP 1800+ chip and 40-GB hard drive, and the \$699 Dell Dimension 2300, one of our highest-rated budget machines.

PC makers understand that the digital revolution has breathed new life and new art into home-movie making. Nearly 10% of all users work with video editing software, up from zilch year ago, according to the 2002 Odyssey Homefront Study, and 41% are editing pictures. That's why some PCs also include secondary drives that allow you to burn DVDs.

About 18% of the desktops sold today include recordable DVD drives.

By 2005, the number is expected to grow to more than 60%, according to Garner Dataquest.

Choosing the right PC boils down to figuring out what you want to do—and living with what you pay for. Cheaper PCs can perform admirably, but likely will be far slower at multimedia tasks than more expensive models. Still thinking about those flashy notebooks that go everywhere? Remember: Desktops offer more capability—at a better price.

By Cliff Edwards

DESKTOPS: BEST OF BREED

BIG SPENDERS

Priced at \$2,000 and above, they have all the latest bells and whistles—and style

PRODUCT/ WEB SITE	PRICE	SPECS	THE GOOD, THE BAD, THE BOTTOM LINE
FALCON NORTHWEST MACH V falcon-nw.com	\$4,895	2.8-GHz Pentium 4, 1-GB RAM, and dual 80-GB hard drives	A thoroughbred gaming system, but it's pricey and noisy. Save big by skipping the custom paint job.
GATEWAY 700XL gateway.com	\$2,999	2.8-GHz Pentium 4, 512-MB RAM, and 120-GB hard drive	Loaded with the latest technology and room to expand. But it has just a one-year warranty.

MIDDLE OF THE ROAD

Priced below \$2,000, these are solid and reliable, with something for everyone

DELL DIMENSION 4550 dell.com	\$1,826	2.66-GHz Pentium 4, 512-MB RAM, and 80-GB hard drive	A solid performer for both games and business applications.
APPLE IMAC apple.com	\$1,199- \$1,999	800-MHz PowerPC G4, 256-MB RAM, and 60-GB hard drive	Superb 17-in. flat-panel screen; easy-to-use software for burning movie and music disks. But it has no expansion slots.

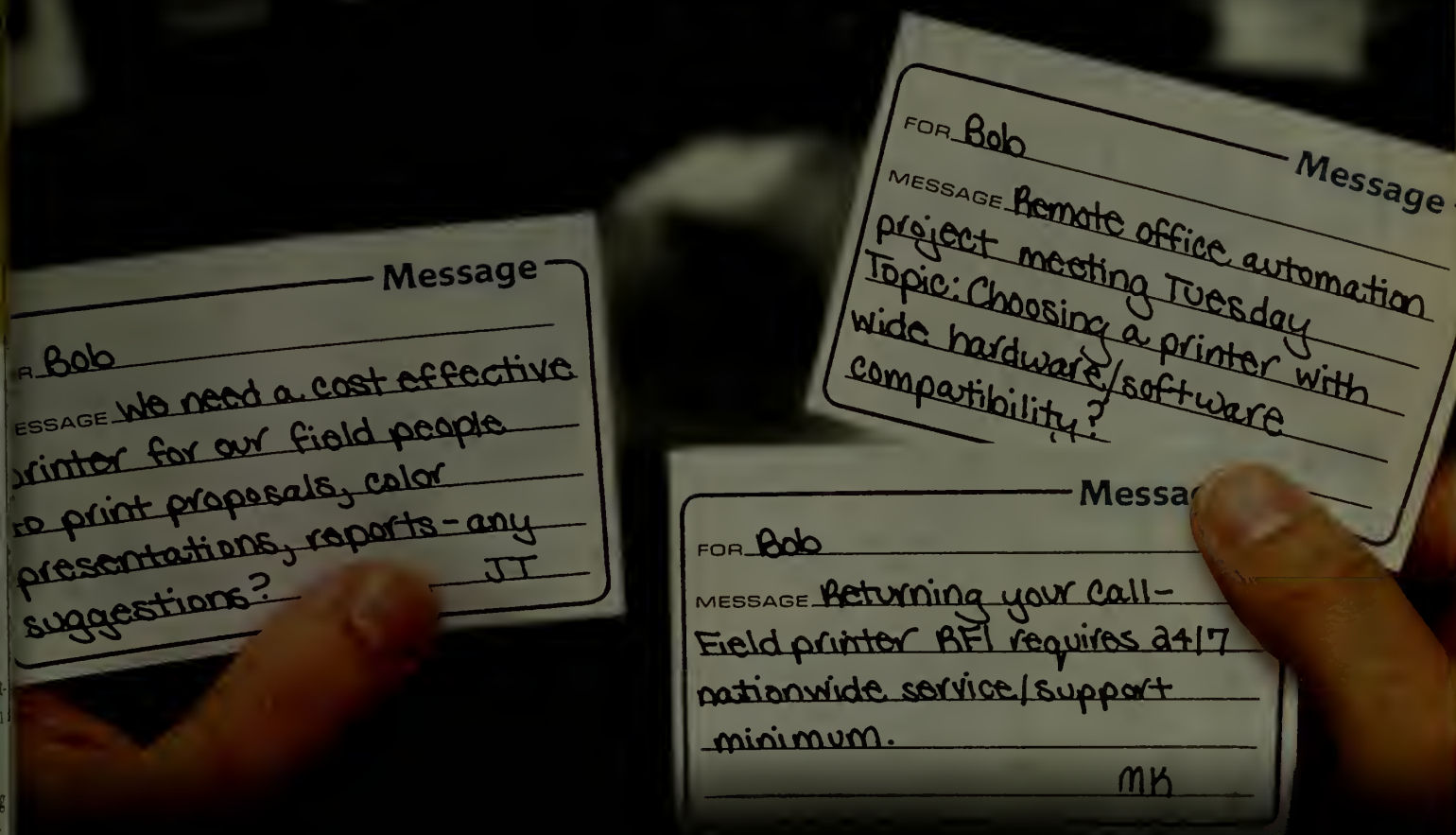
BUDGET-MINDED

Priced below \$1,000, yet they have all the features needed for most of today's applications

IBUYPOWER VALUE XP PC ibuypower.com	\$899	2.26-GHz Pentium 4, 256-MB RAM, and 60-GB hard drive	Great performance for the price, but a network card for high-speed Internet connection costs extra.
DELL DIMENSION 2300 dell.com	\$699	1.8-GHz Celeron, 256-MB RAM, and 40-GB hard drive	Small case is easy to open, but built-in graphics capabilities are too skimpy for gaming.

Data: CNET.com

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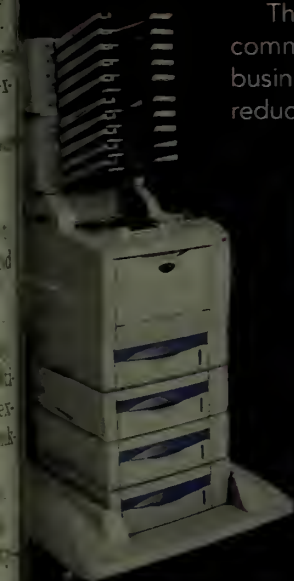
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The Skinny On Flat Screens

Prices have come out of the stratosphere, but keep an eye on image quality

Flat-panel monitors are the runway models of PC equipment—slim, sexy, and full of Hollywood glam. Rather than the bland putty color of most traditional monitors, they sport eye-catching ebony and metallic tones. “They’re gorgeous,” says Douglas A. Balut, a Chicago-area homeowner who bought three 17-inch Samsung displays for his basement sports bar and one for his home office.

It’s easy to be mesmerized by the Versace factor of today’s flat panels, many of which have the sheen of a

sequined evening gown. Compared with cathode ray tubes, the liquid-crystal display technology used in most such panels reduces glare. Many of the models now swivel 360 degrees, double as TVs, and feature panels that are viewable across 170 degrees. That’s key if you’re buying monitors for a team of employees who need to gather in front of one screen.

One good option is the NEC MultiSync 1880sx, which held much of its focus and color when viewed from various angles. To boot, these puppies are no longer priced in the stratosphere. Fifteen-

inchers start just above \$300 and 17- and 18-in. screens run as low as \$650.

Saving space was the main reason Larry Maurer switched to flat panels. To free up room on cluttered desks, the director of information systems for Somerset Medical Center in Somerville, N.J. replaced what he calls “monster” monitors with 300 skinny, 15-in. NEC displays. “We got

professional-looking monitors with the same viewable area as the old ones,” he says.

Which screen is right for you? There are several factors to consider. Size matters, and so does image quality—but don’t jump to conclusions based on specs from a Web site. To figure out your own requirements, visit a store and test several monitors, keeping brightness, color quality, and viewing angle in mind. And make sure to check the picture settings. Manufacturers often crank up the brightness so monitors impress on the showroom floor. One last tip: Beware of “the jaggies”—jagged edges in the text.

Video nuts may want to step up to 17- and 18-in. screens. You’ll pay more, but the picture quality is superior. That’s why Balut turned to Samsung’s \$900-plus 17-in. MP monitors, which double as TVs but aren’t “big, ugly, dusty televisions.” More evidence that, for the right mix of glam and functionality, flat panels are picture perfect.

By Roger O. Crocke



NEC MultiSync
1550V

FLAT-PANEL DISPLAYS: THEY LOOK MARVELOUS

Here are the top flat panels based on price, image quality, and functionality.

15-INCH MONITORS

PRODUCT/WEB SITE	PRICE	THE GOOD, THE BAD, THE BOTTOM LINE
SAMSUNG SYNMASTER 151S samsungmonitor.com	\$325-\$499	Full swivel, terrific tech support, and viewable from various angles. Despite slightly wobbly base, it's No. 1.
NEC MULTISYNC 1550V necmitsubishi.com	\$314-\$449	The most compact of the bunch, with good image quality. Just don't bump the screen; its base tips easily.

17-INCH MONITORS

COMPAQ TFT7020 compaq.com/products/	\$759-\$841	Excellent picture focus and a pleasing price tag, but colors looked inconsistent.
FORMAC GALLERY 1740 (DVI) formac.com	\$949	This bright display with easy setup works with PCs and Macs, but the stand is bigger and flimsier than most.

Data: CNET.com

For more choices, visit businessweek.com



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Mega Storage, Micro Gadgets

These tiny drives make moving gigabytes of data easier than ever

Seven years ago, when I was struggling with my first job out of grad school, I asked my mother to buy me a Zip drive for Hanukkah. The publisher of the Web site I was editing decided to shut it down. If I wanted to show my work to future employers, it all had to get transferred from my office computer to my PC, fast. The Zip drive did the job, but I never had much use for it after that. Without a drive on every computer, Zip disks were kind of like electric cars: useful only when you can find a place to plug them in.

Now, I've discovered a better way: little memory gizmos that plug into computers via the now-ubiquitous USB port or the becoming-ubiquitous FireWire jack. A slew of these portable and pocket devices have emerged over the past year, ranging from solid-state gadgets that hang off your key chain and store up

to 512 megabytes to palm-size disk drives that hold 60 gigabytes or more. They all offer an easy way to back up, shuttle, or archive files—just like floppy disks, but with much more space.

Portable drives have their share of glitches and other

issues. On two models I tested, the software for connecting the drive to the computer was faulty. The SimpleTech SimpleDrive, for example, was

anything but simple, crashing my computer twice. Also, many drives lack security features to protect your files from prying eyes. And the price ranges can be bewildering. Pocket gadgets run from \$15 for 8 MB to \$149 for 128 MB. Or you can get a 20-GB portable hard drive for \$200—or a 60-GB model for \$500.

The need to transport data is so great that people are even hijacking other types of hardware for the

M-SYSTEMS DISKONKEY diskonkey.com

\$80 32 MB

Snazzy design and solid software make this a winner.



TREK THUMBDRIVE thumbdrive.com

\$149 64 MB

Biometric thumbprint scanner is a super security feature.



SIMPLETECH SIMPLEDRIVE www.simpletech.com

\$200 20 GB

Good value and design, but the software is glitchy.

job. Jim Murphy, a school teacher from Chicopee, Mass., first thought of his Apple iPod as a music player. Now he thinks of it differently, using it mainly to

transfer files between classroom and home.

Less creative souls can simply buy one of those lip-stick-size doo-

dads designed to carry files in a pocket. Michael Horowitz, a computer consultant in Manhattan, uses a key-fob-size JMTEK USBDrive that holds 64 MB—equal to about 44 floppies. When traveling on business, he leaves his laptop at home and throws the drive into his

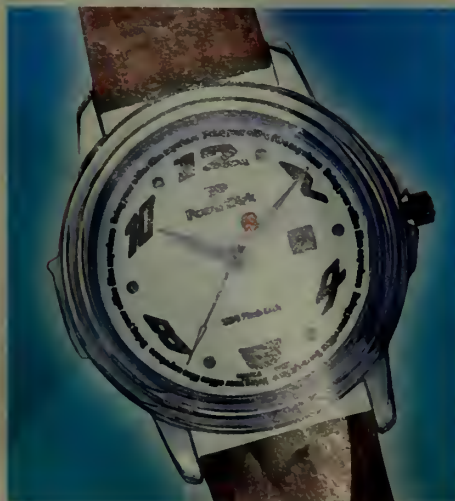
pocket. Ralph Flick, an attorney in Long Beach, Calif., is a more serious data hog, carrying his 20-GB STORIX Compact Drive back and forth

to work every day. The one drawback: The wallet-size tool has no security. As a result, he says: "It's like the nuclear codes. It never leaves my side."

Some products lick this problem. M-Systems' DiskOnKey, for example, lets you create password-protected private zones. And the \$149 Trek Thumbdrive TOUCH key chain device I tested effectively uses fingerprints in lieu of passwords.

My bottom-line advice: Key fobs are fine for music and some simple applications. But for serious work or play, spend the extra dough on a bigger drive. You hear that, Ma?

By Spencer E. Anti



MO'HOTSTUFF

POWERDISK WATCHES

\$149/Marble Watch Co./powerdiskwatch.com

>> For the secret agent in all of us, here's the latest novelty storage item: A watch with a flash drive that connects to your computer via the USB port. The watches come in several different styles, including stainless steel, brass, and leather models. And they offer four storage options, from a thin, 16-megabyte version to a thicker, 128-MB timepiece that goes for \$320. Perfect for smuggling sensitive documents outside of hostile zones.



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MANAGEMENT
INDUSTRY
MEANT MIXING TWO KINDS OF
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The \$199.86 Solution

Microtel's bargain-basement PC is O.K. for basic computing, but face it—the Lindows operating system is a major trade-off

Can a sub-\$200 PC possibly be any good? A new model, the Microtel SYSMAR710, recently was offered for \$199.86 at Walmart.com, so I decided to find out. The bottom line is that it is a minimal but perfectly acceptable piece of hardware for light-duty home use.

Of course, at that price, there are some important limitations. First, it uses a version of the Linux operating system called Lindows, from startup Lindows.com. I think nearly all buyers would be much happier ponying up an extra \$100 for the nearly identical SYSMAR150, which comes with Windows XP Home Edition. And neither model includes a display. So at the very least, you'll need a 15-inch color CRT monitor, starting at around \$120, or a flat-panel display at \$300.

The Microtel PCs achieve their very low cost by using processors with integrated video and audio circuitry



EXTRAS You'll need to buy a display, and you may want to pony up \$100 for Windows software

from Taiwan's VIA Technologies. The 800-MHz processor isn't up to video editing or arcade games, but it's just fine for word processing or Web surfing. The 128 megabytes of memory, 8 MB of which are used for video, is generous for Lindows and adequate for Windows. Both models come with 10-gigabyte hard drives—minuscule by today's standards but

sufficient if you don't collect music or video clips. The Lindows model features a built-in Ethernet network connection, but you'll need to add a modem for a dial-up connection to the Internet. Both versions also include a CD-ROM drive, four USB 1.1 ports, and cheap speakers.

The \$100 Windows premium forced by Microsoft's pricing may seem outrageous. But the fact is, Lindows falls far short of its promise of making Linux attractive to nontechnies. It can, as advertised, run some Windows programs, most notably the Word and Excel components of Microsoft Office. But you'll need to scrounge a copy of the discontinued Office 2000, because the current Office XP won't work.

A Netscape browser is in-

cluded, and \$99 buys you a subscription to the Lindows.com software service. With it, a large number of programs can easily be downloaded and installed, including Sun Microsystems' \$70 StarOffice suite, which offers many features of Microsoft Office. But the programs will be unfamiliar to Windows users, and many, including StarOffice, seem designed for techies.

Then there is Lindows itself. While Linux is a rock-solid operating system, the user interface on this version, a vaguely Windows-like product called the K Desktop Environment, has many rough edges. For example, one of the choices offered by the printer installation wizard is "Remote CUPS server (IPP/HTTP)." Opening the file manager reveals folders, including "root," "bin," and "etc," whose purpose is meaningful only to someone familiar with Unix.

While most anyone should be able to make this work well enough to use the Netscape browser and e-mail program and to type letters in Word or StarOffice, I think the cost in frustration will quickly top the \$100 Windows surcharge. The main appeal of the Lindows version may be to a college student who wants a cheap terminal to run on a campus Unix network. The Windows version, offering the same hardware (except with a modem instead of an Ethernet port), might appeal to a buyer who wants to spend as little as possible and isn't much interested in raw power or multimedia performance.

An inexpensive PC that is usable by nontechnies and that avoids the Windows monopoly premium would be nice. But for now, I have to recommend sticking with Microsoft.

By Steve Wildstrom

PROS AND CONS OF LINDOWS

PROS

- You pay less for systems running Lindows
- The software is stable—no more blue screens of death
- Lindows performs well on minimal hardware

CONS

- There aren't many popular and familiar applications
- The user interface is less polished than Windows
- Tech support may be limited



meeting agenda
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Even after a lot of setting up, your dream might not quite come true

If anybody is ready for the digital lifestyle, it's my 7-year-old son, Will. Dad's job, reporting on technology, is usually incomprehensible to him. But he was pretty excited when I told him I was going to try to set up a wired home. And it was pure magic when I downloaded a collection of James Brown songs from the eMusic subscription service to my PC and played them through my stereo system. When the hardest-working man in show business (that would be James Brown, for the uninitiated) belted out *Say It Loud*, my green-eyed, towheaded offspring boogied around the living room, shouting back: "I'm black, and I'm proud."

The idea behind this project was to see if the much-ballyhooed idea of a wired home had finally become a reality. I dreamed of creating a home network where I could connect computers and a handful of other entertainment devices to one another and to the Web. I wanted to store thousands of songs on a pc and be able to pick out a tune and play it through

my stereo system at a moment's notice. I wanted to record my favorite TV programs on my PC's hard drive and play them back on my own time. I wanted to store my photo album on my PC and shoot pictures off to a digital frame in the living room, so that a different picture could pop up every few days. And I wanted services that would allow me to pick songs and movies from huge Web libraries that I could download whenever the spirit moved me.

Turns out I wanted too much. While I found I could do most of those things, the sad truth is that Will will be a teenager before most of this stuff actually is cheap and easy to use. Right now, the wired home is a mish-mash of technology that we have to patch together ourselves. Some pieces work smoothly. But most of it is too expensive to buy, too challenging to set up, or too limited to be really worth the effort.

Still, I had a blast trying.

Everybody got into the swing of things. My wife rolled her eyes every time I hauled a new gadget into the house, wondering why we really needed a home network or a video-game console that could connect to the Web. But she was pretty hyped about jogging

with Apple Computer's iPod, which now works with Windows PCs, that I loaded with 800 songs from our collection. Neighbor Jim was enamored with a picture frame that cycles through digital photos. And neighbor Whit plugged a wireless card into his laptop to tap

into my high-speed Web link.

To get my connected home up and running, I wanted a powerful PC preloaded with whizzy entertainment software. I went for the new Sony VAIO Digital Studio PC, a \$1,700 unit that includes a tuner card to watch TV and a burner to copy music and video files onto CDs or DVDs.

The next step: Updating my poky old dial-up Internet connection with high-speed access to the Web. Depending on where you live, you can choose between a cable connection or a digital subscriber line (DSL) to rev up your Net link. I picked cable because I could get a higher speed connection at a lower cost—\$45.95 per month vs. \$54.95. And even though I'm paying twice as much as my dial-up connection, I'm zipping through the Net, opening up graphics-heavy Web pages

Welcome to My (Almost Wired



Home

in a jiffy instead of waiting 30 seconds or more for photos to appear.

Then, I added the final bit of technical plumbing to make everything work together: a home network, which connects all the digital devices in my home to each other and to the Internet. I chose the most common type, a wireless one, commonly called Wi-Fi. I could have used a handful of other technologies, such as HomePlug, which routes your files through the electrical wiring in your house, or Home Phoneline Networking Alliance (HPNA), which does the same thing through your phone jacks. And while there are lots of companies making home network gear, I went with Linksys, the market leader.

The keystone of the network is Linksys' wireless router, and hooking up my two computers took a painless 20 minutes. I plugged my aging Compaq Presario into the router with a short piece of cable, and I plugged a little wireless gizmo into the Sony to send signals back and forth to the router over the air. Poof! Both PCs were instantly online.

A week later, my office laptop was online, too, after I slid a wireless adapter, complete with tiny antenna, into a slot on the side. Presto! My instant-messaging software popped up, and

a few seconds later I was zipping through my e-mail during the evening news—all from the comfort of my sofa. It was a defining moment: I decided I couldn't live without a home network.

With the foundation in place, I was ready to roll. The first toy I tried was Sony's Giga Pocket—software that turns the computer into something of an electronic jackalope, part PC, part TV. I just connected the TV jack on the back of the Sony to a cable-TV jack on the wall. Now, I could watch TV on the PC. Even better, I could record TV shows on the hard drive. Heard of TiVo, the personal recording

technology that's revolutionized the TV world? It's similar technology, but without the monthly \$12.95 fee.

You might think that, given the cleverness of Giga Pocket, Sony would have entertainment technology nailed. Not quite. The most annoying part about watching TV on a PC is that—well, it's on a PC. I keep my computer in my home office, which is a cubbyhole of a room in the basement. So where's the gear that sends shows to the TV upstairs in my living room?

O.K., the TV stuff was interesting, but the real thrill of a connected home is getting all sorts of other non-PC

gadgets online. The first thing I hooked up was Microsoft Corp.'s Xbox game console. On Nov. 15, Microsoft will launch Xbox Live, which will let gamers compete against each other over the Net. I'm using an early version of the service Linksys makes something called a Wireless Ethernet Bridge that, for about \$100, does the trick when you're trying to connect to something other than another PC. It took a few steps to set up the Xbox to go online. Within minutes I was playing Revolt, a car-racing game, against three other Xbox Live gamers.

It's relatively easy for devices to share a Net connection. The bugaboo with home networking has always been sharing files stored in the computer with other computers or other digital devices. Not one of the suppliers has made it easy. And that's exactly where I ran into trouble with the \$299 AudioTron, the one piece of

THIS NEW HOUSE

Seattle Bureau Chief Jay Greene pieced together different devices and services to see if he could make the much-hyped wired home a reality. Here's what he used:

DEVICE	MODEL/ WEB SITE	PRICE	THE GOOD, THE BAD, THE BOTTOM LINE
PC sonystyle.com	SONY VAIO DIGITAL STUDIO PC (MODEL PCV-RZ14G)	\$1,700	A very nice, if somewhat pricey, PC to serve as the hub of a wired home. It's loaded with several nifty programs to watch and record TV edit home movies, and burn CDs and DVDs.
WIRELESS ROUTER linksys.com	LINKSYS WIRELESS ETHERNET ROUTER (MODEL BEFW11S4)	\$129	This allows you to share a high-speed Internet connection among PCs and other devices. It's easy to use and works smoothly with wireless gizmos from other suppliers.
DIGITAL PICTURE FRAME digi-frame.com	DIGI-FRAME (MODEL DF-1710)	\$2,999	Too expensive for the masses, and a bit challenging to set up. But it offers a glimpse of things to come: Sending photos from a PC to a picture frame.

Data: BusinessWeek, company reports



MO'HOTSTUFF

SPEEDSTREAM POWERLINE NETWORKING
\$99/Efficient Networks/speedstream.com

>> Until now, to move data over home electric lines, you had to connect a dictionary-size box to every PC. But Efficient Networks has managed to fit all the electronics into a tiny package that plugs directly into wall outlets, just like AC adapters. If you're already wireless, there's also a plug-in to extend over-the-air signals to the basements and backyards a wireless network sometimes can't reach.

BusinessWeek online

For a review of online gaming, go to the Nov. 11 issue online at www.businessweek.com



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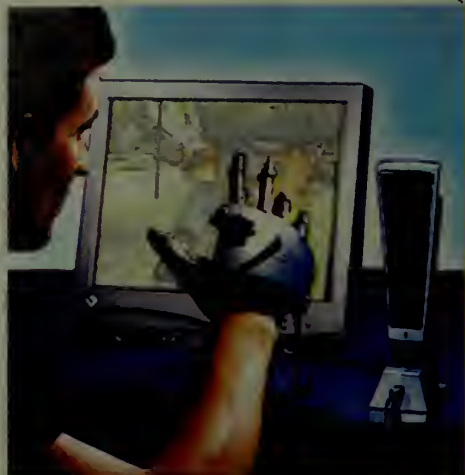
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my setup that I had most eagerly anticipated. It's a slick gadget that sits among your stereo components and connects to a PC. In theory, it pulls your music files from your PC and plays them through your stereo.

As much as I wanted it to work, the AudioTron tripped me up time and again. I used the wireless bridge to connect the AudioTron to my home network. But the setup program could never connect the AudioTron to the VAIO, so my 800 songs stayed trapped inside the PC. I finally had to call customer support to get the system working.

I also played around with another music player—the Apple iPod for Windows—and grew to love it. When it appeared a year ago, it worked only with Macintosh computers. Even with such a limited market, it was a hit. In August, Apple introduced three versions of the iPod that work with Windows PCs, including the one I used, a \$399 model that holds 2,000 songs.

There's a lot to love about the iPod. Its sleek design is almost sexy. Its storage capacity is mind-bog-



gling. But the best part is that it's the easiest MP3 player I've ever used. It's simple to wade through hundreds of songs on the six-line, backlit display. Apple has built in a scroll wheel to rifle through your music library, which automatically switches to a volume controller when music starts playing.

A handful of Web sites are offering consumers the ability to listen to music and watch movies online. I subscribed to eMusic because, unlike its competitors, eMusic will let me download and copy files to other players, such as the iPod, with no extra charge.

MO'HOTSTUFF

P5 GAME GLOVE

\$149/Essential Reality Inc./essentialreality.com

>> Here's a gadget that will make the kids gasp: The virtual-reality game glove from Essential Reality takes over functions a mouse or keystrokes now perform in PC games. Instead of point and click, just point and twitch a finger. Initially, it comes bundled with two PC games worth \$90, Hitman 2 and TigerHunt, to make that \$149 tab go down more smoothly. Play Station and Xbox versions should arrive in 2003.

For \$9.99 a month, it's a fine service, if you don't mind the esoteric mix of music. The major music labels seem to loathe the idea, fearing that customers will copy their entire catalogs and quit the service after a month. What's there is a ragtag collection of independent labels and musty old tunes. I downloaded a John Hiatt album and songs from Otis Redding, Mojo Nixon, and Johnny Cash. But if you're looking for Britney Spears, you've come to the wrong place.

The final piece of my home network was a digital picture frame. Unfortunately, it's nearly impossible to

find digital frames that can plug directly into a home network. But I found digi-frame: At \$2,999, it's hardly a gadget for the masses.

The device is essentially a 17-inch flat-screen monitor with computing power and network connection built in.

It wasn't too hard to get digi-frame up and running. I used the wireless bridge once again to connect the frame to my network. The slightly geeky user's manual walks you through setting things up. It took me about 30 minutes. I picked a handful of my favorite snaps—then drag-and-dropped them into a special folder dedicated to the picture frame. A second later, a shot of Sam's 4-year-old, sticking out his tongue, popped up on the screen.

For all its pitfalls, the wired home can be a lot of fun. Sure, it's too difficult to get devices connected to one another. Prices of the

truly compelling gadgets are way too steep for my budget. And, to be honest, I'm not sure I would have had the patience to get everything hooked up if it wasn't part of my job. Right

now, the wired home has a lot more going against it than for it. But the second it gets easier and cheaper, you can count me in.

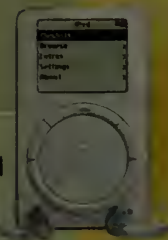
By Jay Gree

THE MUSICAL NEST

There's quite a variety of gizmos to get you set up to whistle a happy tune, but it's easy to hit some sour notes along the way:

DEVICE	MODEL/ WEB SITE	PRICE	THE GOOD, THE BAD, & THE BOTTOM LINE
DIGITAL AUDIO RECEIVER turtlebeach.com	AUDIOTRON	\$299	This device is for playing digital music files on a PC through a stereo system. Sadly, setting it up is too challenging.
DIGITAL MUSIC PLAYER apple.com	IPOD FOR WINDOWS (10GB MODEL)	\$399	The iPod is a beautifully designed music player that stores gobs of music in a small space. And wading through a huge music collection is a breeze.
ONLINE MUSIC SERVICE emusic.com	EMUSIC	\$9.99 a month	eMusic lets you download songs and play them on other devices. Other services are catching up, offering similar features but at higher prices. The music selection is thin, though.

Data: BusinessWeek, company reports



THE ISSUES. THE CAMPAIGNS.
THE RESULTS.



ELECTION: 2002

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Securing A Digital Home

You wouldn't leave your car unlocked.
So why invite cyber criminals inside?

So you've bought that brand-new personal computer and, this time, you've signed up for an always-on digital subscriber line (DSL) or a cable-modem connection. Now, you're surfing with impunity, only faster.

Guess again. The instant you hook that PC up to the Internet, you become a target for the menagerie of ne'er-do-wells crawling through cyberspace. Welcome to the growing and, unfortunately, necessary world of personal firewalls. A firewall in your PC acts like a metal detector in an airport. It screens potentially dangerous data traffic from going inside. Dozens of

firewalls are on the market today, and most sell for under \$50. They install in less than an hour, and they all do the same thing—shut down and hide computer ports so outsiders don't even know your machine is connected to the Net.

The programs provided by your PC's manufacturer or your Internet service provider aren't enough. Microsoft's Windows XP operating system has a firewall built in. But it's up to you to turn it on—and you face a devil of a time figuring out how to do it. Here's a timesaver: Go to the software's home-network sec-

tion, open the "properties" menu, and click to turn on the firewall.

But even then, there are security holes that can be easily exploited by cyber fiends. To make Windows XP easier to service, Microsoft set up the software to let a Microsoft support person fix it over the Net. Problem is, a hacker can turn that con-

venience feature against you and use it to take over your system.

Similarly, don't be misled by the gear you need to set up a home network. A router acts like a natural firewall because it hides multiple computers behind your Internet address. Some even say "firewall" on the box. But one of the biggest problems facing home users these days are so-called Trojan-horse viruses—seemingly innocuous files masquerading as downloads or e-mail that, once in your computer, allow someone to monitor your machine or take it

over. A router can't help you there because it won't alert you to suspicious outbound traffic. But a good firewall can.

In general, the best firewalls, such as the Norton, ZoneAlarm, and Sygate firewalls, inspect what's coming in to your PC and turn away anything that's up to no good. And they alert you if sensitive data, such as passwords or credit-card numbers, mysteriously head to the Net from your PC.

There's one more thing to keep in mind: You are the weakest link. It's tempting to simply turn off a firewall when it sounds an alarm or prevents you from visiting a Web site. Don't. Or at least don't forget to turn it back on after you figure out what's going on. Once you've gone to the trouble to get it running, you might as well use it to keep scoundrels at bay.

By Jim Kerstetter



PROTECT THAT HOME NETWORK

Personal firewalls are a necessity, not a luxury

PRODUCT/WEB SITE	PRICE	THE GOOD, THE BAD, THE BOTTOM LINE
ZONEALARM PRO. 3.0 zonelabs.com	\$49	Includes an ad blocker and a cookie manager, and hides PC access from hackers. No antivirus defense, no version for Macs, and no phone support.
NORTON PERSONAL FIREWALL 2003 symantec.com	\$29-49	Easy to use for beginners. Advanced settings are hard to find. A better deal when bought as part of Norton Internet Security (\$39-\$70).
SYGATE PERSONAL FIREWALL PRO 5.0 sygate.com	\$39	Detects even the most advanced attacks. It's difficult to configure, and the \$75-per-call phone support makes it better suited to skilled users.

Data: CNET.com

For more information see BusinessWeek Online

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A Sharper Focus for Digital Shutterbugs

Do you really need all those bells and megapixels? Here's a guide to help you figure it out



The kids' soccer game sidelines I frequent are loaded with digital photographers these days. Yet judging by the deep frowns and occasional expletives, digital cameras are rivaling VCRs for baffling buttons and controls, not to mention a bewildering set of specs and features. Time and again, I hear: "I'll have to read the manual someday because I know I can do a lot more with this thing than I do."

Part of the problem is that aggressive salespeople push the more expensive cameras, the ones with the most megapixels. That determines how large your final prints can be and still look sharp and clear. If your goal is filmlike prints even at the 8-by-10-inch size and above, you're likely to want 3 to 5 megapixels. Aquarium hobbyist Randy Carey of St. Paul, Minn., for example, uses a 3.14 megapixel Nikon Coolpix 990 to snap the zippy tetras in his 60 aquarium tanks. He gets sufficient de-

tail for him to publish the results in fish enthusiast magazines.

But photographers like Carey actually, ahem, read the manuals. I've discovered that some of the happiest digital photographers these days have cameras with simple controls, quality just good enough for their particular needs, and as small a size as possible. That way, they tend to take their cameras everywhere they go and not just drag them out for special occasions. "Megapixels are like megahertz in a

SIMPLE Court Smith picked a compact Canon S330 for her business, and it does the job

computer," says Jeff Bonforte, a former dot-com executive now taking a breather in Switzerland. "It's a myth that you need as many as you can get." He prefers a compact 2-megapixel Canon Digital ELPH that he even takes on the airplanes from which he skydives three times a week. He has clicked off some 1,500 shots in the past 18 months.

Unless you're a pro or serious hobby shooter, some basic, practical needs should dictate your digital camera choices, and I'd lump those needs into three user groups. First, there are the True Digis. These are tech-savvy folks, often young, like Bonforte: They take lots of pictures, but they mostly e-mail and post their photos online. For them, the camera's size matters most, and less is invariably better. Two cameras on our list will suit them best: the Canon PowerShot S330 Digital ELPH and the Minolta Dimage X. Both are lightweight, have about 2 megapixels, are straightforward to use, and list for \$399 (nearly every camera's list price can be beat with some shopping).

The next group, the Snappers, want to use their digital camera like they did their regular camera, for holidays and vacations—and yes, those soccer games. They probably do some e-mailing to Grandma, but they also want prints, either printed at home, at the drugstore, or at an online service such as Ofoto. For the best results, they need at least 3 megapixels.

That much horsepower typically comes with lots of features, but you'll have to take the time to find them. Jerry Grossman, vice-presi-

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Swiss Watch and Jewelers: Alhambra, CA, San Gabriel, CA • William Barthman Jewelers: New York, NY

dent of marketing for consumer digital products at Nikon, says that all manufacturers are struggling to make their manuals easier to use. Nikon is experimenting with CD-based lessons and other ways to help customers discover such automatic modes as Nikon's "beach" exposure well before the sun sets on their seaside shooting.

One nifty Snapper camera is the Canon PowerShot S30. It's relatively compact, sports 3.2 megapixels, and lists for \$599. I found the controls on this camera confusing at first, but after spending 20 minutes reading the manual and playing with the camera, I found its logic appealing.

The final category I'll call the eBay brigade. They use digital images to support their own small-business activities, whether at eBay or their own Web sites. They even create marketing material that they previously hired a photographer to handle. Charlene Court Smith of San Francisco used to be a creative director for the home furnishings



MO'HOTSTUFF

DPP-EX5 DIGITAL PHOTO PRINTER
\$200/Sony Electronics/sonystyle.com

>> Stand this printer next to your TV or PC and turn out high-quality photos in a snap. The prints are a bit pricey, from 58¢ for a 4-by-6-inch glossy to 80¢ for a sheet of nine adhesive stickers that are postage-stamp size. But the thermal process prints the continuous tones of professionally processed prints rather than the sprayed-on dots of most home printers. It's the instant gratification of digital photography taken to the next step.

store Pottery Barn, but she left to launch her own hand-made jewelry business. She sends digital shots of her jewelry around the world to help find the rare shells and bones she uses, and sends photos of finished pieces to high-end boutiques and stores. She might have opted for a camera like the Fujifilm Finepix S602 Zoom. Running around \$650, it's a near-professional-grade, 3-megapixel camera with an excellent close-up or "macro" lens. However, the compact Canon S330 ELPH works for her. "It seemed

the most intuitive of the cameras I looked at," she says.

Such online sites as dpreview.com or imaging-resource.com are extremely helpful for digital camera shoppers. But nothing beats a fact-finding trip to the store. How else will you know whether your big fat thumb fits on the Minolta Dimage's thin, square little body, for example? Be realistic about how much printing you'll want to do, and pay attention to how natural the controls seem. If deleting a shot or switching from

landscape to close-up settings seems overly complicated, seek out a simpler camera.

Two more technical details to research: battery type and life (Will AAs work, or do you have to buy a \$40 or \$50 rechargeable just to get a spare?) and storage (What kind of memory cards does it store images on, how much do they cost, and how many images will each hold?).

Once you've got the camera, set aside some time to work with snapshots on your computer. For me, that has become more than half the value of digital photography. For example, my husband and I were considering a painting for our living room. The artist let us take a digital photo of it,

which I brought home and merged with a photo of the room. It took 15 minutes to convince us we had the perfect spot for it.

Such tricks may require an extra investment in a photo-manipulation program like the \$99 Photoshop Elements. But investing some time in learning all that you can do with the camera and its images has a nice payoff. It may save you a little money, and you'll have a lot more fun.

By Joan O'C. Hamilton

YOU SAY YOU WANT HIGH RESOLUTION?

Sometimes portability is as important as pixel count

CAMERA/ WEB SITE	PRICE	RESOLUTION MEGAPIXELS	WEIGHT OZ.	THE GOOD, THE BAD, THE BOTTOM LINE
CANON POWERSHOT S30 usa.canon.com	\$368-\$599	3.2	9.2	Compact camera produces great images. Control icons are a bit overwhelming for new users.
FUJIFILM FINEPIX F602 ZOOM fujifilm.com	\$499-\$798	3.1	17.6	Well-placed controls and excellent image quality overcome low pixel count. But grip may be too deep for small hands.
CANON POWERSHOT S330 DIGITAL ELPH usa.canon.com	\$266-\$399	2.0	8.6	It's sleek and pocket-friendly but may not have enough resolution for oversize prints.
MINOLTA DIMAGE X www.minolta.com	\$242-\$389	2.0	4.8	The ultracompact is great for go-anywhere shooting. But images can be inconsistent, especially in backlit shots.

Data CNET.com

For more information see *BusinessWeek* Online



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to install your Microsoft Wireless
Broadband Network.

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CHARITY BEGINS WITH A FISCAL CHECKUP



BY ROBERT BARKER
rb@businessweek.com

The Charity Navigator Web site helps you figure out whether a nonprofit has its financial house in order before you make a donation

Especially this year, no one wants to waste charitable contributions on inefficient or unstable groups. So it's fortunate that a Web site has popped up to help figure out which charities have their fiscal houses in order. It's called Charity Navigator, it's free, and, while there's some controversy about it, it's worth your while to check it out at charitynavigator.org.

There, you will see that CN has rated 1,747 of the nation's leading charities. After evaluating several financial measures, CN has awarded each of the charities from zero to four stars. Each also gets its own CN Web page, with its stated mission, plus lots of details about expenses (including the top official's pay), comparisons with peers and links to contact the charities directly. CN also offers searching and screening tools.

Basic data on nonprofits, drawn from the Internal Revenue Service Form 990 that they must file annually, have been freely available online for a few years at guidestar.org. While GuideStar, funded by a group of foundations, covers far more charities, CN stands out by adding free analyses and ratings. John Dugan, chairman of a drug marketing company called PDI, came up with the idea after PDI went public in 1998, and Dugan aimed to step up his giving. Trouble was, he found no handy way to evaluate charities' finances. So, with a \$1.5 million grant, he seeded CN. "We don't owe anything to anybody," Dugan said.

Not everyone is entirely happy. What drives CN's ratings are purely quantitative formulas, such as some for working capital, revenue growth, and the part of a charity's budget taken up by overhead costs. CN is "an additional piece to informed giving," said Rich Cowles, executive director of the Charities Review Council, a St. Paul (Minn.) group that evaluates nonprofits in Minnesota. "But it creates a danger because the public wants simple answers, and they're giving a simple answer."

Realities may be more complex. Christine Benninger, executive director of the Humane Society of Santa Clara Valley, a three-star charity in California, said she expects its rating to suffer in coming years as the group shifts its main mission from animal control toward education and adoption. For one thing, its working-cap-

ital ratio is certain to fall because it just took \$1 million out of its endowment to buy land for new shelter. And since it will be giving up animal-control contracts with local governments, its revenue growth will also be hit. "Somebody who really doesn't know us will say: 'Wow, you've gone from a three-star rating to one star,'" she said. Officials of other charities, including some of the lowest scorers (table), lauded CN's goal but criticized the means as inflexible.

CN's method is so unbending that it won't go beyond data found on the latest Form 990—even to update what it knows is wrong. CN executive director, Trent Stamp, concedes CN is imperfect and allows there's room for debating better methods. "If [charities] can explain their donors why we're wrong, and they be-

CHARITY NAVIGATOR
your guide to intelligent giving

CN's Top Scorers . . .

CHARITY	MISSION
Scenic Hudson Land Trust	Environmental conservation in New York
Jewish Federation of Metropolitan Chicago	Social, cultural, educational services
Second Harvest Food Bank of Santa Clara, San Mateo Counties	Food distribution in California
The J. David Gladstone Institutes	Medical research
Lake Forest Open Lands Assn.	Environmental conservation in Illinois

. . . And Lowest

WJCT	PBS affiliate, Jacksonville, Fla.
Hale House	N.Y.C. children's crisis shelter
Multiple Sclerosis Assn. of America	Health
Agape Villages	Social services in California
New Life Corp. of America	Religious, humanitarian relief

Data: Charity Navigator, BusinessWeek

lieve it—great. That creates a dialogue," he said.

In any case, CN already is helping donors. The Johnson, domestic capital-markets desk chief at the Federal Reserve Bank of New York, told me he had wanted to donate to a fund focusing on heart disease or stroke. He discovered CN, used it to compare several possibilities, and wound up selecting the American Heart Assn. "It's hard to have a perfect way to rate charities, but because I'm in finance, this made sense to me," he said. "The methodology is transparent, so you can make your own judgment." Before writing checks, it's the least you can do.

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INTUIT STEAMS AHEAD



BY GENE G. MARCIAL

Intuit's tax-prep software is on a fast-growth track. Will fresh sign-ups for Cox cable push up the stock? Hot sales of security info systems are boosting Veridian

Intuit (INTU) is one tech stock that has survived the wreck. This maker of financial software is up 41% this year—from 34 in February to nearly 50.95 on Oct. 30. Its products let households and small businesses automate tax preparation, payroll, and accounts. "The company has been a standout, beating analysts' estimates," says money manager Tom Galvin of Forstmann-Leff Associates, which has been buying shares. Demand for Intuit software is rising, notes Galvin, as the company continues to develop special products for such businesses as construction and real estate. Tax-preparation software, however, continues to account for 36% of sales.

Although the stock does not seem cheap on a price-earnings basis, it is undervalued based on Intuit's growth rate of 35% to 42% a year, says Galvin, who has a 12-month target of 58 to 62 a share.

Analyst Mary Meeker of Morgan Stanley says what makes Intuit so attractive is its solid growth in revenue, operating income, and cash flow—and its having met or beaten estimates in the past two years. Besides, she says, it has a strong balance sheet, with \$3.1 billion in cash, and an intense focus on the bottom line. Management has reiterated its revenue estimates of \$1.7 billion to \$1.8 billion for fiscal 2003 ending July 31, and operating earnings of \$1.30 to \$1.35 a share. Meeker figures Intuit will earn \$1.31 in fiscal 2003 and \$1.75 in 2004. It has the potential for "impressive operating margin expansion in 2003 and beyond," says Meeker, who gives the stock an "overweight" rating. She owns shares, and Morgan has done banking for the company.

MORE SUBSCRIBERS TUNE IN TO COX

If you think broadband communications is the next hot spot, grab shares of Cox Communications (COX), urges John Maloney, president of M&R Capital. He thinks Cox, the fifth-largest cable operator, is a bet on value as well as growth. The stock, which fell 7.6%, to 27.85, on Oct. 29, after posting a third-quarter loss of \$73 million, or 12¢ a share, is at a low valuation not seen since 1996, says Maloney. The loss was mainly due to a write-down of its equity stake in Sprint's wireless unit. But for Maloney, this is the time to snap up Cox—while the cable industry is reeling from Adelphia Communications' woes. Cox, 68% owned by Cox Enterprises, has "stable cash flow and the strongest balance sheet in the industry," says Maloney, who bought shares when they were trading

at 29 last week. It closed at 28 on Oct. 30. Cox's subscriber numbers have exploded, and its big capital outlays are ending, so cash flow has been growing, notes Maloney. Cox has 6.3 million subscribers, of whom 1.7 million also pay for digital cable-TV services. But its fastest-growing segment is high-speed access to the Internet, for which it has 1.3 million customers. Maloney expects this will jump to 2 million in 2003. Cable telephony, now with 600,000 subscribers, is also growing fast: He expects that number to hit 900,000 in 2003.

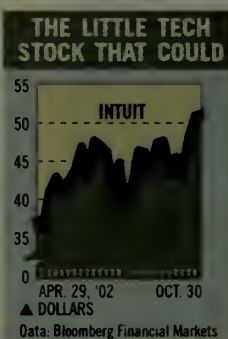
Maloney figures Cox is worth 38, based on estimated 2003 cash flow of \$3.40 a share. Analyst Niraj Gupta of Salomon Smith Barney rates the stock "overweight." He says Cox deserves premium valuation, compared with its peers, because of its "superior growth prospects, excellent assets, and investment-grade balance sheet."

WHY VERIDIAN HASN'T BOMBED

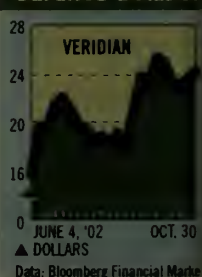
Although most defense stocks have tumbled late, Veridian (VNX) has been flying high, leaping from 16 a share in June to 24.25 on Oct. 30. This provider of information systems and services for the government—focusing on national security programs for intelligence, defense, and law-enforcement agencies—has snared some big contracts, the latest of which was a five-year \$1 million U.S. Navy deal that is expected to add \$1 million in profits in 2003. "The win confirms Veridian's strong positioning in the market for IT services [in defense]," says Edward Caso of Wachov Securities, who rates the stock a buy. Wachov has done banking for Veridian. Andrew Addison, editor of *The Institutional View*, says international political considerations as well as increased homeland-security spending will create more demand for Veridian services. In October, Veridian bought Signal Corp., also a security technology outfit, whose sales and earnings have been growing 20% a year because of business with agencies such as the Federal Aviation Administration and the Justice Dept. Consensus earnings estimates for Veridian are 80¢ to 85¢ a share for 2002 and 95¢ to \$1 for 2003. Addison's 12-month stock price target is 35 a share.



MALONEY: Cox stock has hit bottom



BUOYED BY THE DEFENSE BUILDUP



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BusinessWeek online

Read Gene Marcial's Inside Wall Street Online column Tuesdays afternoons at www.businessweek.com/today.htm. And see it Fridays at 1:40 p.m. EST on CNNfn's *The Money Gang*.



This is the story of
a philanthropist
who donates millions to charity but
refuses to waste a dime.

People who donate large sums to charity tend to be frugal. No matter how much money they give away, they don't want to see any of it wasted.

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That's a lot of dimes. More importantly, it means that more of your donation goes to charitable causes, and less is consumed by "overhead."

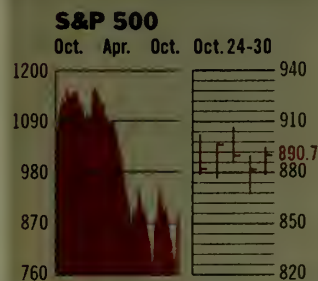
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Stocks



COMMENTARY

Equities weathered some bad economic news, including warnings from auto makers of weaker sales, a drop in durable goods orders, and a sharp decline in consumer confidence. But expectations of further rate cuts by the Fed and a focus by investors on the profit outlook for 2003 lifted the markets. For the week, NASDAQ nosed up, while the Dow and the S&P fell a bit.

Data: Bloomberg Financial Markets
Reuters

U.S. MARKETS

	Oct. 30	Week	Year to date	Last 12 months
S&P 500	890.7	-0.6	-22.4	-16.0
Dow Jones Industrials	8427.4	-0.8	-15.9	-7.6
NASDAQ Composite	1326.7	0.5	-32.0	-20.4
S&P MidCap 400	425.1	-0.8	-16.4	-5.2
S&P SmallCap 600	193.9	0.2	-16.5	-3.3
Wilshire 5000	8391.6	-0.5	-21.6	-14.2

SECTORS

	Oct. 30	Week	Year to date	Last 12 months
BusinessWeek 50*	568.4	-0.7	-22.1	-18.2
BusinessWeek Info Tech 100**	287.0	2.4	-31.6	-22.4
S&P/BARRA Growth	460.7	-1.0	-22.5	-15.5
S&P/BARRA Value	426.9	-0.1	-22.7	-17.0
S&P Energy	180.4	-2.8	-14.6	-14.3
S&P Financials	304.7	0.1	-14.2	-7.4
S&P REIT	87.0	1.4	-6.8	-0.3
S&P Transportation	166.7	-1.9	-15.4	-2.0
S&P Utilities	92.7	4.9	-36.4	-38.2
GSTI Internet	76.5	1.5	-27.1	-6.1
PSE Technology	449.6	1.4	-34.6	-23.9

*Mar. 19, 1999=1000 **Feb. 7, 2000=1000

BEST-PERFORMING GROUPS

	Last month %	Last 12 months %
Internet Software	56.6	49.8
Wireless Services	53.3	41.8
Semiconductor Equip.	34.4	35.6
Intgrd. Telecomms. Svcs.	31.5	35.2
Computer Hardware	29.5	26.2

EQUITY FUND CATEGORIES

	4-week total return %	52-week total return %
Leaders		
Technology	9.2	43.6
Communications	9.0	8.6
Large-cap Growth	3.7	7.7
Large-cap Blend	3.3	7.1
Laggards		
Precious Metals	-5.8	-37.1
Japan	-5.4	-34.2
Real Estate	-4.1	-26.3
Natural Resources	-2.4	-24.4

EQUITY FUNDS

	4-week total return %	52-week total return %
Leaders		
Jacob Internet	26.0	70.5
RS Information Age A	24.1	60.4
RS Internet Age	23.8	56.1
Sm. Barney Telecoms. Income	23.3	55.3
Laggards		
Rydex Dynam. Venture 100	-22.0	-61.6
ProFunds UltraShort OTC	-22.0	-59.7
American Heritage	-12.5	-59.2
Rydex Arkto Investor	-10.8	-58.8

GLOBAL MARKETS

	Oct. 30	Week	Year to date
S&P Euro Plus (U.S. Dollar)	813.4	3.3	-24.8
London (FT-SE 100)	4002.7	-0.1	-23.3
Paris (CAC 40)	3084.2	3.1	-33.3
Frankfurt (DAX)	3113.6	3.3	-39.7
Tokyo (NIKKEI 225)	8756.6	0.5	-16.9
Hong Kong (Hang Seng)	9560.5	-2.5	-16.1
Toronto (S&P/TSX Composite)	6330.4	-0.1	-17.7
Mexico City (IPC)	5963.8	-0.6	-6.4

FUNDAMENTALS

	Oct. 29	Wk. ago
S&P 500 Dividend Yield	1.78%	1.76%
S&P 500 P/E Ratio (Trailing 12 mos.)	28.4	29.7
S&P 500 P/E Ratio (Next 12 mos.)*	16.1	16.2
First Call Earnings Surprise*	2.90%	2.99%

*First Call Corp.

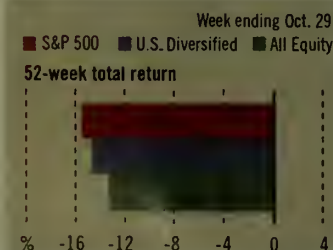
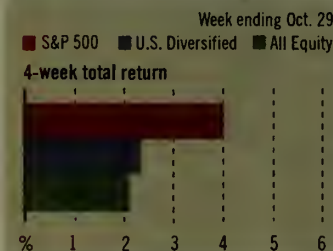
TECHNICAL INDICATORS

	Oct. 29	Wk. ago
S&P 500 200-day average	1006.0	1012.5
Stocks above 200-day average	20.0%	20.0%
Options: Put/call ratio	0.75	0.76
Insiders: Vickers NYSE Sell/buy ratio	1.53	1.44

WORST-PERFORMING GROUPS

	Last month %	Last 12 months %
Commercial Printing	-15.5	Multi-Utilities
Automobiles	-15.3	IT Consulting
Tires & Rubber	-13.5	Wireless Services
Constr. & Engineering	-11.9	Telecomms. Equip.
Auto Parts & Equipment	-10.0	Gas Utilities

Mutual Funds



Data: Standard & Poor's

Interest Rates

KEY RATES

	Oct. 30	Week ago	Year ago
MONEY MARKET FUNDS	1.35%	1.35%	2.00%
90-DAY TREASURY BILLS	1.49	1.66	2.00
2-YEAR TREASURY NOTES	1.74	2.14	2.00
10-YEAR TREASURY NOTES	3.96	4.23	4.00
30-YEAR TREASURY BONDS	5.03	5.16	4.00
30-YEAR FIXED MORTGAGE†	6.07	6.36	6.00

†BancQuote, Inc.

BLOOMBERG MUNI YIELD EQUIVALENTS

Taxable equivalent yields on AAA-rated, tax-exempt municipal bonds, assuming a 30% federal tax rate.

	10-yr. bond	30-yr. bond
GENERAL OBLIGATIONS	3.88%	4.00%
TAXABLE EQUIVALENT	5.54	6.00
INSURED REVENUE BONDS	4.08	5.00
TAXABLE EQUIVALENT	5.83	7.00

THE WEEK AHEAD

FACTORY INVENTORIES Monday, Nov. 4, 10 a.m. EST ► Manufacturing inventories are forecast to have fallen by 0.4% in September, after holding steady in August. That's according to the median forecast of economists surveyed by MMS International. Uncertainty over Iraq and the economy most likely led manufacturers to further draw down inventories rather than boost production.

FOMC MEETING Wednesday, Nov. 6, 9 a.m. EST ► The Federal Reserve Board's Open

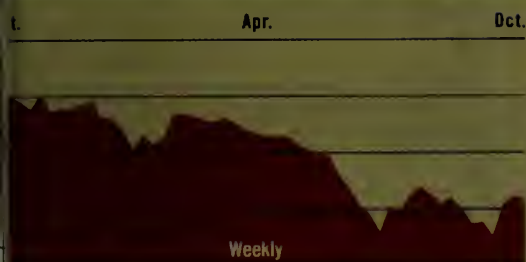
Market Committee will meet to set monetary policy. In light of the October drop in consumer confidence, Fed-watchers increasingly think policymakers will trim the federal funds rate by a quarter-point, to 1.5%. Sentiment is also growing for another cut by yearend.

PRODUCTIVITY & COSTS Thursday, Nov. 7, 8:30 a.m. EST ► Output per hour worked during the third quarter most likely accelerated to an annual rate of 3.5%, and quarterly unit labor costs probably re-

mained unchanged. In the second quarter, productivity rose at an annual rate of 1.5%, while unit labor costs increased 2.1%, their first rise in a year.

INSTALLMENT CREDIT Thursday, Nov. 7, p.m. EST ► Consumers most likely assumed an additional \$4 billion of new debt in September. In August, growth in consumer credit moderated to \$4.2 billion. The accumulation of nonrevolving debt fell sharply in August to just \$6 billion, despite strong sales in vehicle

BusinessWeek Fifty

THE
BUSINESSWEEK **50**

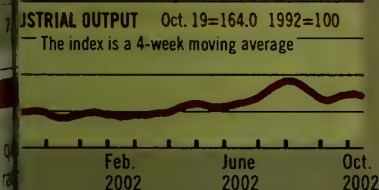
50 fell fractionally for the week ended Oct. 30. Tenet Healthcare, which had been a stellar performer, fell 22.9% on fears that its Medicare reimbursements may not grow. Also fueling the decline was Amerada Hess, which reported a weak third quarter and suffered a debt downgrade by Moody's. KLA-Tencor, which makes monitoring equipment for chipmakers, rose 10.9% on analyst upgrades.

COMPANY PERFORMANCE

Company	% change		Rank	Company	% change	
	Week	Since 3/1/02			Week	Since 3/1/02
Johnson & Johnson	-1.1	-5.9	26	Tenet Healthcare	-22.9	1.2
Apple Mac	-2.4	-2.7	27	Household International	-11.9	-54.8
Merck	3.3	-21.8	28	WellPoint Health Networks	-7.1	29.1
Amerada Hess	3.6	-13.0	29	Washington Mutual	-0.4	9.3
Chip Morris	-3.6	-21.5	30	Duke Energy	0.1	-42.9
KLA-Tencor	10.9	-37.4	31	Kohl's	2.8	-15.8
Home Depot	-3.4	-13.5	32	Bed Bath & Beyond	-3.0	6.1
Wal-Mart	-0.7	-5.1	33	Cardinal Health	1.2	5.6
Target	-0.2	-51.6	34	Centex	-6.7	-23.0
ResourceBergen	-1.8	8.3	35	American Electric Power	18.9	-40.9
UnitedHealth Group	-5.0	31.5	36	Golden West Financial	0.0	8.2
Johnson	5.2	2.3	37	Stryker	0.5	1.0
Home Depot	-3.2	-41.1	38	Harley-Davidson	-2.7	3.6
Wal-Mart Stores	-6.0	-13.2	39	PepsiCo	-1.8	-13.3
Target	-10.2	-96.9	40	Merck	5.6	-11.6
General Dynamics	-2.9	-13.0	41	Apache	-3.0	3.0
Amgen	2.5	-16.8	42	Amerada Hess	-22.6	-26.4
East Laboratories	1.4	24.5	43	KB Home	-9.2	4.9
Wal-Mart (H&R)	-3.5	-12.7	44	First Data	1.9	-15.0
United	-7.4	-72.9	45	Tyco International	5.7	-49.4
Dental Petroleum	-5.9	5.4	46	International Game Technology	2.7	13.5
Wal-Mart	2.2	8.6	47	Capital One Financial	-1.4	-36.4
Home Depot	-6.2	-13.5	48	Electronic Data Systems	-0.9	-76.7
Wal-Mart Oil	-2.8	-24.4	49	Nabors Industries	-5.5	-0.2
Wal-Mart Group	4.5	-12.6	50	Xcel Energy	1.9	-54.8

Production Index

Change from last week: -0.4%
Change from last year: 1.8%



Production index declined during the latest week. The calculation of the four-week moving average, the index fell from 163.6 to 162.7. The seasonally adjusted output of steel dropped sharply, followed closely by electric power production, coal, and lumber. Also lower for the week. Among the items that increased, crude-oil refining showed a gain. Truck assemblies and rail-freight also rose.

For each of the index components is at www.businessweek.com.
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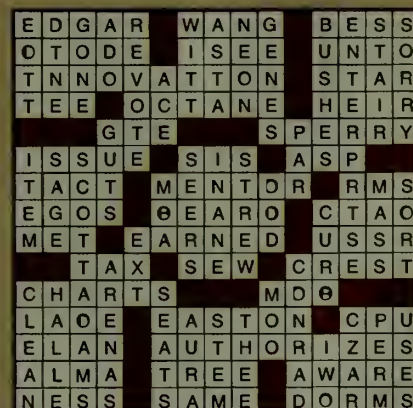
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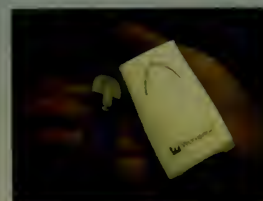
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VOTERS IN SUSPENDED ANIMATION

Is it safe yet? As Americans go to the polls in the first general election since September 11, they find themselves in the most un-American of positions: uncertain about the future, wary of the present, and unsure of the path back to the optimism and prosperity of the recent past. They hope the measures taken against terrorism and business scandals are sufficient, but they fear they're not. Americans long for the physical and economic security of the '90s, but snipers on suburban streets just outside the nation's capital and backtracking on financial reform leave them feeling vulnerable still. They waver between the optimism offered by a recovering stock market and pessimism over a looming war with Iraq. The latest measure of consumer confidence reflects American fears: Expectations about the future are dismally low. No one appears willing to bet on the future. CEOs wait to spend on new capital. Investors wait to return to the stock market. Everywhere, people hesitate.

Past elections have seen the country divide along ideological lines, with lucid issues and disputed solutions. This time there is dichotomy, but the campaigns seem oddly divorced from the issues of the day. There is no national theme addressing the deep concerns of the people. Neither political party offers a compelling argument or a clear direction. The campaigns feel empty and artificial, with candidates simply pushing hot buttons on a predictable set of tired old issues, such as Social Security or health care. Negative TV attack ads just turn us off. As a result, we have concluded that this election will not do what we want it to do—turn a corner, take a stand, introduce policies that will make our world safe, predictable, and prosperous again. It may be that one party or the other will sweep both houses of Congress, but it is just as likely that Americans will settle for the status quo because it doesn't really matter.

THE GOOD LIFE TURNED BAD

No one understands this more than the twentysomething generation. Most entered the workforce during the boom years, when their world was full of promise. Paid highly, praised fulsomely, recruited fiercely, they now feel abandoned. Since 2000, the market has crashed, the Twin Towers have fallen, anthrax has arrived in the mail, the economy has soured, raises have stopped, bonuses have disappeared, and layoff after layoff has rendered more of the young jobless. The business world twentysomethings found so glamorous and appealing in the '90s has been tainted by corruption and scandal. And the big cities they moved to in droves in search of exciting jobs are increasingly filled with homeless people and danger. For the first time since 1991, violent crime is up. Is it any wonder that the young now worry that their brief encounter with the good life was a mere blip, and the desultory days of the present are going to be the norm? It's hardly just the young who fret: Fiftysomethings watch their dreams of retirement drift away, while they see despair replace hope in their children's eyes. Their lives, and the econ-

omy, revolve around their houses—liquefying equity and investing in real estate because everything else is too risky.

We try to draw confidence from the way our nation quickly responded to the twin shocks of September 11 and the financial meltdown, with the President showing strong leadership. The military vanquished the Taliban quickly in Afghanistan, and Congress, regulators, and the market themselves moved with dispatch to punish those responsible for accounting, business, and Wall Street scandals. The Justice Dept. destroyed Arthur Andersen for its sins with Enron Corp. Corrupt CEOs were arrested. Wall Street firms were fined. Legislation was passed. Things were done. There was momentum for change.

A MISSED OPPORTUNITY

Then, it stopped. The Homeland Security Act that was supposed to set up a huge new agency to protect America from terrorism got caught up in partisan politics and never passed. Airports were never completely secured, and little progress has been made in safeguarding trains, trucks, and ports. The Securities & Exchange Commission capitulated to political pressures, and the new accounting oversight board is in danger of being co-opted by the industry it is supposed to check. Congress mandated corporate governance reform, then starved the SEC of funds to implement them. The initial post-September 11, post-Enron wave of punishment for evildoers and bad guys is not being followed by long-term institutional changes that protect us from future terrorist attacks or financial betrayals. America's leaders are missing a historic opportunity that we all may regret.

So we still don't know if we are safe. We are reduced to hoping against hope that terrorists won't attack America again even as we see how easy it is to kill innocents in Baghdad, Jordan, or Maryland suburbs. We hope, too, that the stock market will rocket again even as we see how fragile the recovery is becoming. We feel risks all around us that are difficult, if not impossible, to manage. And we—CEOs, investors, consumers, travelers, plain citizens—pull back, hoping for the best, fearing the worst.

Americans know their world has been blown apart, but they haven't yet found a way to fashion a new one. They know that the only way back to peace and prosperity is through building security and confidence. The midterm election might have offered them a way to do this if politicians had stepped up to the task. By and large, they did not. As a result, the campaigns appear divorced from the fears and needs of the people and seem irrelevant. As long as American political and economic leaders avoid finishing the job of building new institutions for the higher-risk world we live in—no Homeland Security Dept. or new oversight for accounting and Wall Street—we will continue to live in a state of foreboding. In this day and age, complacency and passivity only make us more vulnerable.

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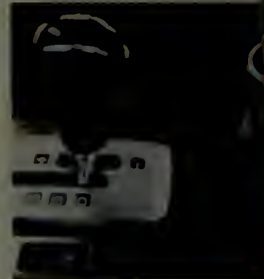
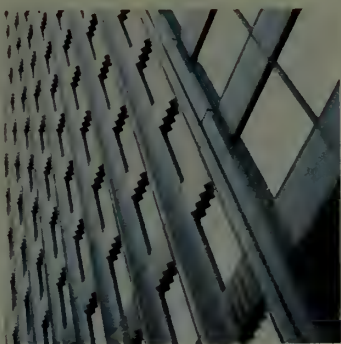
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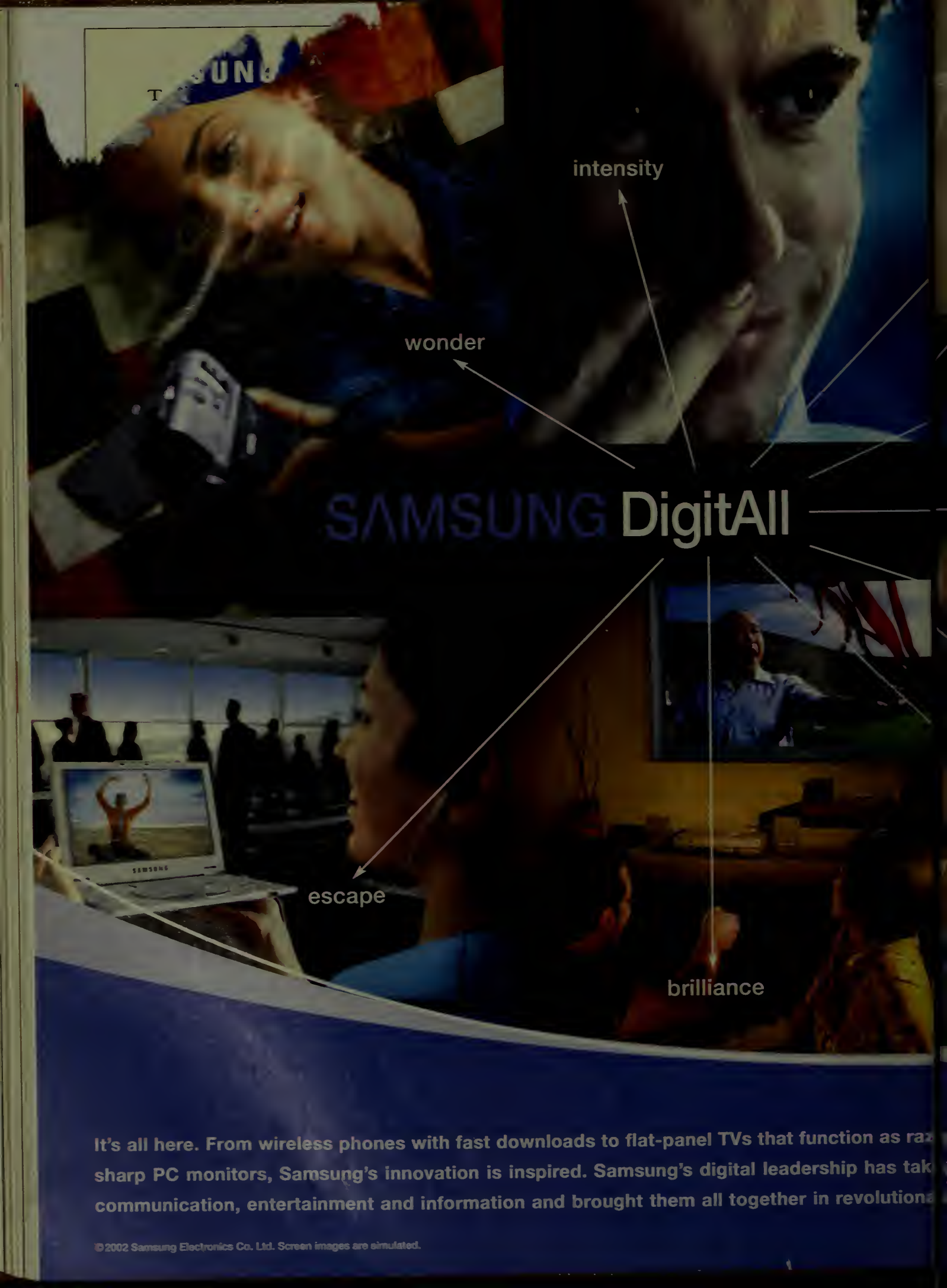
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When Comcast Corp. closes its \$45 billion acquisition of AT&T Broadband, Comcast CEO Brian Roberts will effectively become media's top gatekeeper. One in every 10 U.S. homes will be an AT&T Comcast customer. Nobody will have more control over which TV channels, Internet services, and movies are piped into U.S. homes. But at the same time that Roberts is establishing himself as a new kind of media mogul, the cable industry faces suspicion about its accounting practices and tough competition from satellite

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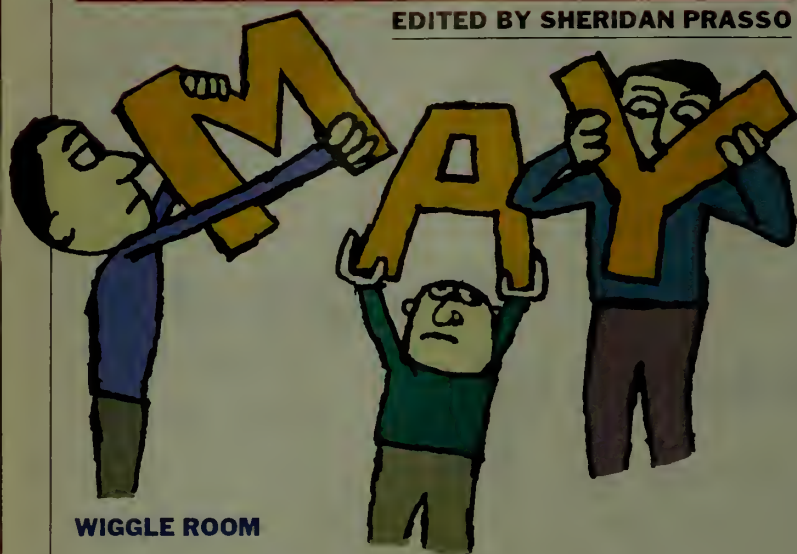
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WHAT DOES 'MAY' MEAN, ANYWAY?

REMEMBER BILL "IT DEPENDS on what the meaning of the word 'is' is" Clinton? Perhaps his influence is still being felt at the Securities & Exchange Commission, where officials have been spending a fair bit of time pondering the meaning of the word "may."

Why the debate? New financial disclosure rules will soon require companies to reveal off-balance-sheet transactions—à la Enron—that "may" have a material effect on their financial condition. So SEC commissioners, the chief accountant, and the general counsel all spent at

least 15 minutes debating the word at an Oct. 30 meeting. They settled on this: "May" should mean a "more than remote" chance of having a material impact. Then again, "more than remote" still leaves considerable room for interpretation.

SEC Commissioner Paul Atkins says his English professor would have loved the semantics discussion. "There will always be scoundrels who try to twist the meaning of words," he says. "We just have to catch them and bash them on the head." Now that's clear. *Peter Coy*

THE LIST STAYING PUT IN INDONESIA



BALI AFTERMATH

The recent terrorist bombing in Bali rattled American companies operating in Indonesia, but few will pull out. Companies were asked if they planned to:

	YES	NO
ORDER EXPATRIATE EMPLOYEES TO LEAVE	1%	93%
ORDER EXPATRIATE DEPENDENTS TO LEAVE	2	93
AUTHORIZE VOLUNTARY DEPARTURE OF EXPATRIATE DEPENDENTS	30	63
AUTHORIZE VOLUNTARY DEPARTURE OF EXPATRIATE EMPLOYEES	22	74

Survey of 107 companies, conducted mid-October

Data: American Indonesian Chamber of Commerce

TALK SHOW "I see a Republican breeze blowing."

—Senator John McCain (R-Ariz.), early on election night.

SEX ABUSE

THE UAW ANSWERS A CRY FOR HELP

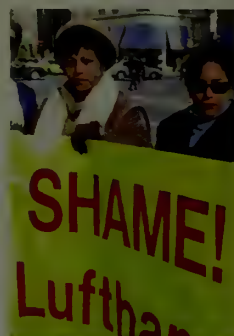
IN A HIGHLY UNUSUAL MOVE, the United Auto Workers is going after Lufthansa airlines and Subway sandwich shops to protest alleged abuses. It's leafleting at ticket counters and stores on behalf of nonunion female workers at a Connecticut dough factory owned by Lufthansa subsidiary Chef Solutions, breadmaker for Subway and others.

The 200 employees, mostly Hispanic and many illegal, claim that top managers engaged in sex abuse such as threatening to fire them or turn them or

family members in to U.S. authorities if they didn't submit to sex. Five managers—including the plant manager who is a woman—were fired or moved over the past year after the workers filed civil rights charges and sought help from the UAW, says the union, which also represents non-union workers.

The workers still have more grievances—including alleged firings for trying to join the union. "If you listen to these women's stories, it will make you cry," says Phyllis Wheeler, UAW Region 9A director.

Trish Beck, vice-president for human resources at Chef Solutions, says the company has been investigating the complaints. *Aaron Bernstein*



SAD STORIES

ON THE WATERFRONT

SLOW BOAT TO CALIFORNIA

THE LOCKOUT BY WEST COAST dockworkers claimed some unsuspecting victims. Even after it ended on Oct. 10, a huge backlog of cargo remained stuck at sea for weeks. And not just car parts and rotting bananas. Other items that didn't make it off the boat were 57,000 cameras from Hong Kong that the San Francisco Giants intended to give away at game four of the World Series.

The game went on, but others weren't so lucky. The University of California at Los Angeles had to postpone an Oct. 23 production of the play *Quick Lime* when sets and costumes got held up. Carpenters built a new set from scratch,

and two of the three performances went on as scheduled. Still, the university lost more than \$10,000 in potential ticket sales.

The Los Angeles Opera had its own drama. Sets for *Lady Macbeth of Mtsensk* did not arrive from Russia in time for a late-October opening night. So a messenger from



STALLED: Sets and camera

the Kirov Opera hand-delivered a 30-pound roll of blueprints to L.A., so designers could recreate the set. "When you sell a half-million dollars worth of tickets, you don't want to cancel," says opera spokesman Gary Murphy. Indeed, the show must go on and did. *Arlene Weintraub*

strength + agility = performance



Photo: Al Seib. Costumes: Dominique Lemieux. © 1999 Cirque du Soleil Inc.

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Up Front

Q&A

THE NYSE? FUGHEDABOUTIT

THE NEW YORK STOCK Exchange is committed to staying in New York. So said NYSE Chairman Dick Grasso in an interview with Editor-in-Chief Stephen Shepard on Oct. 31 as part of BusinessWeek's ongoing "Captains of Industry" series with the 92nd Street Y in Manhattan. Here are some excerpts:

Before September 11, the NYSE had planned a new building near its headquarters at 11 Wall St. The attack put an end to that. What are you going to do now?

We have been proud to have New York as half our name for 211 years. So that's not going to change....I will tell you, being a native New Yorker, the institution being the anchor of New York's financial district...we have no desire to move out of the city of New York. Building a [secondary] facility outside of New York is the last of our last options.



GRASSO: Staying put

The last resort would still be in New York State? No question. There is no N.J. in my future.

You're mentioned as a possible successor to Treasury Secretary Paul O'Neill. Would the job interest you?

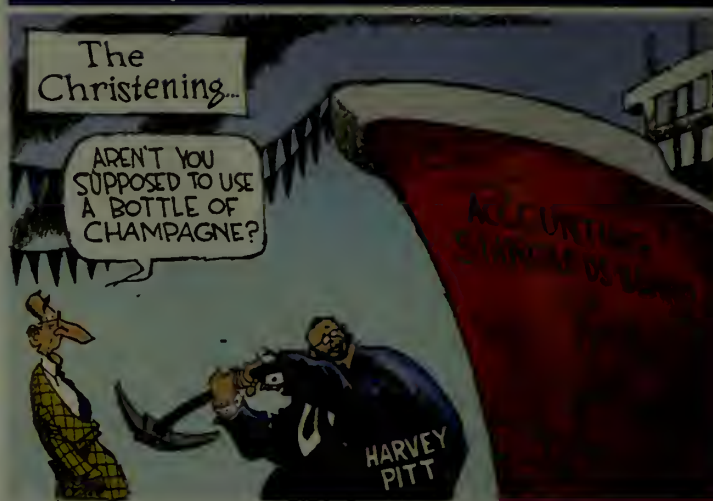
I walked into 11 Wall St. on Apr. 10, 1968, and I fell in love with the place. It's the... only job I ever will have. When I'm finished—and some say the sooner the better—I'm going to work with sick kids—kids with cancer.

Growing up, did you have a role model?

I worked in a pharmacy. The pharmacist, Harry Rosenbaum, taught me how to fill prescriptions so that he could spend all his time looking at the Standard & Poor's guide [and investing in stocks]....The more Harry said, "You'll be a great pharmacist," the more I wanted to understand what he was doing in the stock market. That's where I caught the bug actually.

For a full transcript of this interview, go to www.businessweek.com

DRAWN & QUARTERED

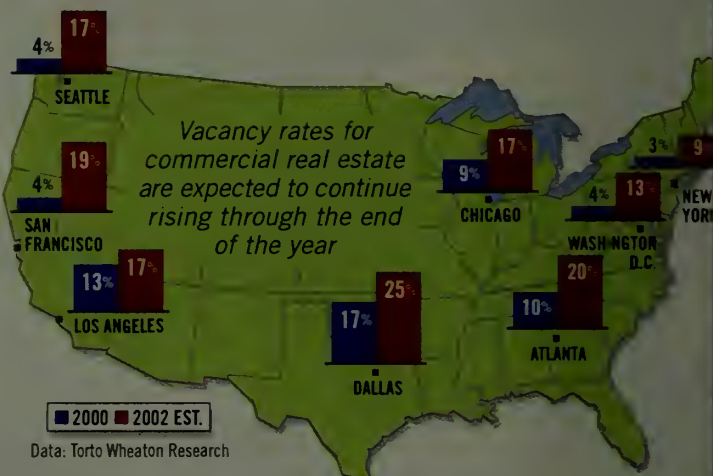


AS THE DOWNTURN TURNS

HAVE WE GOT A DEAL FOR YOU: OFFICE SPACE

WILL ROGERS ONCE ADVISED folks to buy land because they aren't making any more of it. But these days, no one seems to want the space

about a year or two of free rent. "It has turned from a landlord's market to a tenant's market," says Jacque DuCharme, president of leasing



that's already here. In a reverse land rush, tenants across the U.S. are vacating offices—often paying penalties for canceling leases—as they retrench or close shop.

The result: Big-city vacancy rates, which were mostly in single digits two years ago, average more than 15% today. Real estate experts say they're likely to rise further.

For companies shopping for new space, this spells bargains. In San Francisco and Silicon Valley, rents have tumbled by 50% or more since their 2000 peak. New tenants there are demanding—and typically getting—goodies, such as discounts on remodeling, that work out to

agent Julien J. Studley Inc.

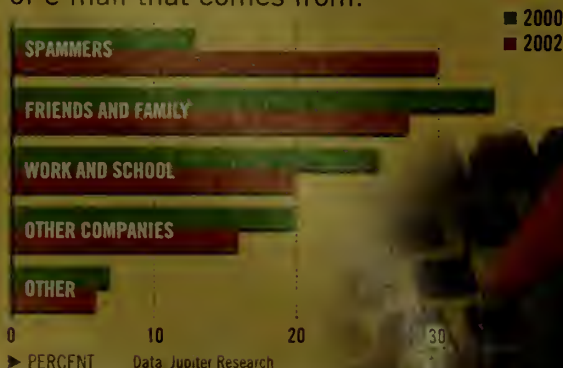
One standout, for now, is New York. While its downtown is suffering—vacancy rates have quadrupled since 2000, to 13%—Midtown has remained strong, with the vacancy rates still in single digits.

Equity Office Properties Trust, the nation's biggest office-building owner, reports tenants handing back 1.8 million square feet of floor space in the third quarter. CEO Samuel Zell doesn't see improvement until job growth picks up. When will that happen? Judging by the last "jobless recovery" a decade ago, Zell says, maybe a year from now. *Michael Arnaut*

THE BIG PICTURE

THE ORIGINS OF E-MAIL

Spam is a growing problem. Here is the share of e-mail that comes from:



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With this issue, BusinessWeek Investor introduces a new page, Dividends, edited by Toddi Gutner, with fact-filled snapshots on money, investing, deals, gadgets, gear, business travel, and other interesting and useful news flashes. Dividends will also include "Time Off"—suggestions for time well spent when you've got a few extra minutes on a business trip.

Our feature Investor story, the latest in our series, "The Fine Print,"

looks between the lines of analysts' reports and explains how to use the information you find there. (Start by disregarding the buy-sell-hold recommendations and price targets.) And we report on real estate investments for your IRA.

This week, we also provide a user's manual for the business suit, which is making a sharp-looking return, after a hiatus of a few years. We also advise fitness swimmers on how to improve their strokes and get more benefit from a workout.

There's much more to come. Next week, we will feature a

Special Report on "Finding a Financial Adviser," a collaboration of the BusinessWeek and USA Today financial reporting teams.

BusinessWeek Investor's new design was created by

Fahey and David O'Connor of FaheyOConnor, working with Associate Art Director Alice Cheung.

Kick back, have a glass of wine, and enjoy our new personal section.

Stephen B. Shepard
 Editor-in-Chief



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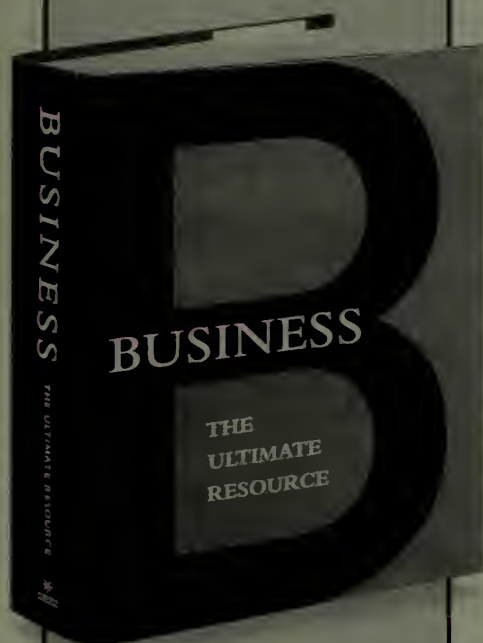
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Readers Report

SO LONG, SILICON VALLEY?

Although China's technology benchmarks are comparable to those of other large economies, the country's scientific output is way below that of others, because most of the technology is either borrowed or stolen ("High tech in China," Cover Story, Oct. 28). Should future U.S. government policy legitimize and facilitate such exports of technology, brace yourself for an exodus of intellectual property. Take one last good look around, and we may as well kiss Silicon Valley good-bye. Exports of sensitive technology should be restricted to democracies and those who demonstrate their willingness to become democracies—or else we will be encountering situations such as Afghanistan, Iraq, North Korea, and Pakistan over and over again. China will prove to be no exception.

Nagesh Kuppuraju
Robbinsville, N.J.

As a supplier to the electronics manufacturing industry in both Asia and North America for 25 years, we have seen a cataclysmic shift of high-technology electronics manufacturing to mainland China during the past five years, which has accelerated since China became a member of the World Trade Organization. The top tier of the U.S. electronics industry has systematically exported basic and value-added manufacturing, both of which are fundamental vehicles for the creation of wealth. More than 200,000 jobs in electronics have been lost since 2000, not only in the U.S. but also Mexico. If an Intel Corp. or Motorola Inc. abandons North America for lower costs, where will the ability to develop the next generations of technology come from?

Matthew Holzmann
Newport Beach, Calif.

INSTANT RUNOFF VOTING: AN IDEA WHOSE TIME HAS COME

There is a simple solution to both major parties' fear that third parties will "spoil" their elections: instant runoff voting ("The greens vs. the Dems: Another nightmare on Election Street?" Washington Outlook, Oct. 28). Instant runoff voting is used in Ireland (to elect the President), in Australia (to elect the House of Representatives), and in London (to elect the mayor), and it will be used for all San Francisco elections beginning in 2003. IRV is already used by absentee voters in Louisiana. Voters in-

CORRECTIONS & CLARIFICATIONS

In "My favorite mutual fund" (BusinessWeek Investor, Nov. 4), the charts showing return and risk of the average balanced mutual fund were incorrectly labeled. The average balanced mutual fund posted an annual average total return of 7.1% and volatility of 10.7% during the 10 years ended Sept. 30.

In "Why Veridian hasn't bombed," (Inside Wall Street, Nov. 11), a \$154 million contract won by Veridian will add \$15 million to sales—not to profits—in 2003.

dicating their second choice at the same time as their first, and the winner must receive a majority of the vote.

Steve Chessin
Californians for Electoral Reform
Mountain View, Calif.

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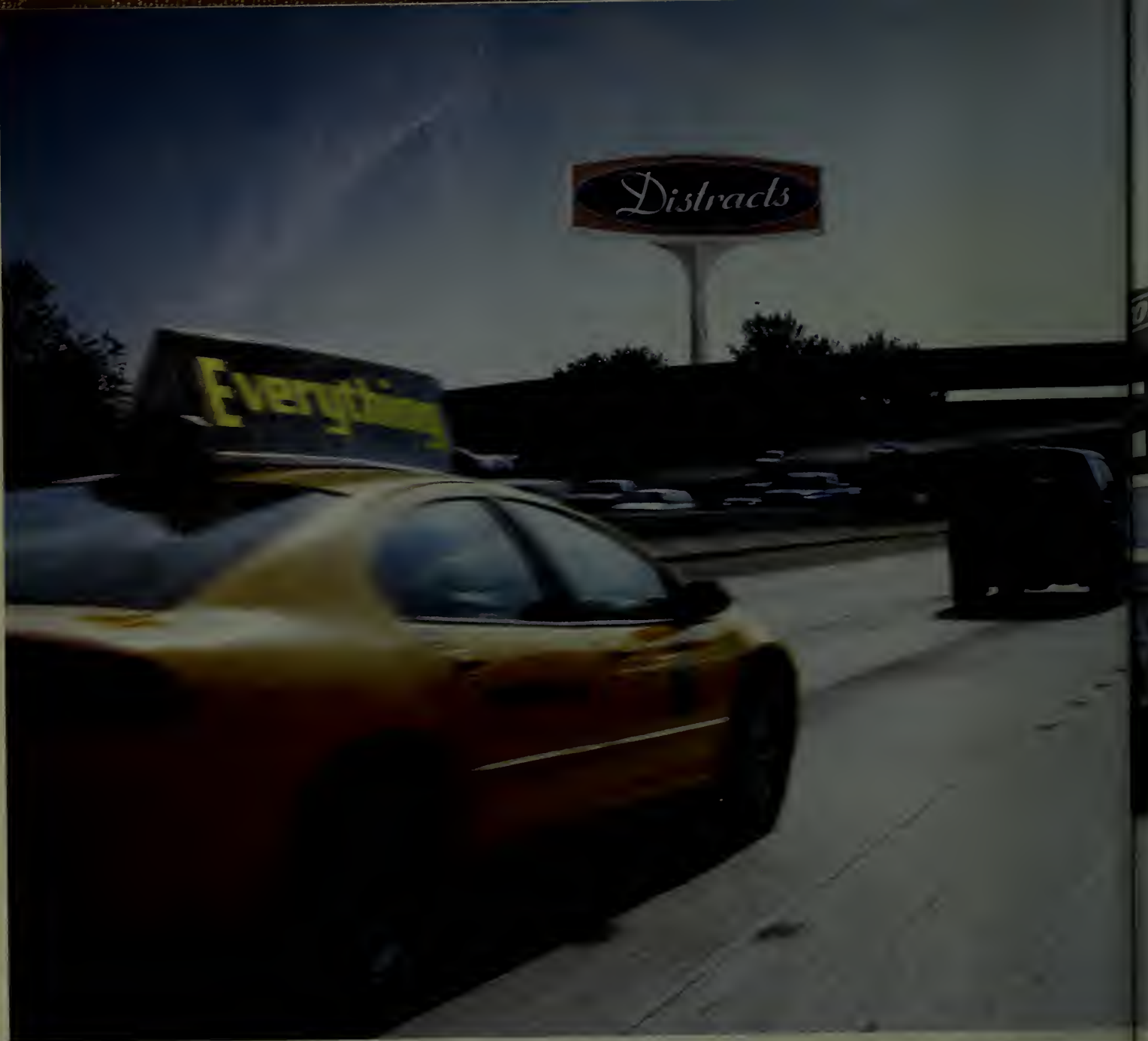
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Answers for questions to come.

SMART MOBS

The Next Social Revolution

By Howard Rheingold

Perseus • 266pp • \$26

COMING ON THE NET: PEOPLE POWER

The dot-com bust has left many technology entrepreneurs and investors so weary and wary that they're actually hiding from new ideas. Big mistake. Nearly a decade after the Web browser ignited the Internet, it may well be time to gear up for the next tech revolution. But this time, the spark may not be another gadget or "killer app" software. Instead, it may well be a new social movement, contends Howard Rheingold in his new book, *Smart Mobs: The Next Social Revolution*.

Rheingold knew something was up when, on a trip to Tokyo in 2000, he suddenly noticed that more people were staring at their cell phones than talking into them. What he soon discovered was that these *oyayubizoku*, or "thumb tribes" as they're called in Japan, were using their phones to exchange instant messages, forging new kinds of ad-hoc social groups. He also found a Japanese matchmaking service, called Lovegety, that alerts people on their mobile phones if someone with the mate-worthy attributes they've chosen is nearby.

That was just the start. Rheingold soon realized that people had gone way beyond "receiving stock quotes or email on the train or surfing the Web while walking down the street." For example, he found that the huge demonstration in Manila that resulted in President Joseph Estrada's overthrow last year was largely sparked by cell-phone users who were forwarding text messages over the Net. He found a Web site, upoc.com, that lets fans track celebrities by coordinating reports from cell-phone users. Even al Qaeda's use of wireless and Internet technologies fits the pattern he was beginning to see.

The collision of computing, always-on communications, and physical mobility, he says, is producing "smart mobs"—groups of people who can do something together even if they don't know each

other. An astute observer of the social impact of technology and the author of several books, Rheingold thinks that, for better or worse, this will build into a wave as big as the ones caused by the PC and the Internet—especially since phones and other Net-linked mobile devices will surpass the number of online PCs next year.

Rheingold doesn't yet see a business strategy for the wireless Net, which has failed so far to live up to the hype. But as Net-connected devices from sensors to cameras shrink to the point where they can be slapped onto any object or even woven into clothing, Rheingold thinks something entirely new will emerge. He predicts people will be accompanied by a digital aura that will reveal where they are, what they're doing, and what's happening there.

This aura will allow them to form far-flung social groups only hinted at by the Internet communities Rheingold wrote about in his 1993 book *The Virtual Community*. Their actions could change everything from business to politics to journalism. "Imagine the impact," he writes, "of the Rodney King video multiplied by the people power of Napster."

Rheingold isn't the first to notice these developments. But his notion of smart mobs is a provocative distillation, a sort of unified field theory of current tech thinking. It explains such disparate things as the surprising endurance of eBay Inc.'s online marketplace and the phenomenon of thousands of people sharing their computers' processing power to aid the search for extraterrestrial life. Indeed, his notion may be a little too neat in its inclusiveness. One might wonder whether some of the things he describes, such as the thumb

tribes of Tokyo, might prove to be mere fads, like citizen's band radio.

At times, Rheingold tries a bit too hard to buttress his cogent observations with academic theories that draw parallels between smart mobs and swarms such as ant colonies. Here, his questions are more interesting than the few answers he finds. He wonders, for instance, whether electronically created swarms of humans—who, unlike ants, possess complex intelligence—will result in a similar collective intelligence or something entirely different. He also wonders: "Will nascent smart mobs be neutralized into passive, if mobile, consumers of another centrally controlled mass medium? Or will an innovations commons flourish, in

which a large number of consumers also have the power to produce?"

Clearly, Rheingold hopes for the latter—that the power of smart mobs could be used to create a more democratic power he dubs "ad-hocracy." Perhaps, but wasn't that what the Internet was supposed to have done already? Instead, established business interests such as media companies are on the verge of fencing off the Internet "commons"—

virtual space that was once shared by all.

To his credit, though, Rheingold goes out of his way to point up the potential dangers, from the rise of techno-terrorism to the erosion of privacy. He notes that the U.S. military is leading smart mob-technology development, planning to test wearable computers with Global Positioning Systems and wireless communications next year. He fears the encroachment of commercial interests even more. "Will we be wiser in our choices of how to use the small screen in our hand than we were with the TV screen in what used to be the family room?" he asks. "The question is whether we have the wisdom to use our power-tools without amputating something vital."

Raising such questions is the chief contribution of *Smart Mobs*. Rheingold hopes that if we know that smart mobs are coming and what impacts they may have, we may be able to make the best of them. That's debatable, but at least this book gives us the chance to try.

BY ROBERT D. HOF

Hof is Silicon Valley bureau chief



RHEINGOLD FORESEES STRANGERS FORMING NEW KINDS OF ONLINE GROUPS FOR JOINT ACTION

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BY STEPHEN H. WILDSTROM

tech&you@businessweek.com

THE MICROSOFT PEN IS A MITE CLUNKY



The new Tablet PCs hold promise for select users, but they aren't ready for prime time

Many computer professionals have a long-standing practice of never buying the first version of anything from Microsoft. It's a good rule to keep in mind when considering the new Tablet PCs unveiled by Microsoft and an assortment of hardware and software partners on Nov. 7. The Tablet brings welcome innovation to an increasingly hidebound PC market, and it may end up being, as Microsoft claims, "the evolution of the notebook PC." But the initial hardware and software that I tested have an unfinished feel and look to be a year or two away from being ready for mainstream use.

The goal of the Tablet PC is to make it possible to control a computer with a pen. The pen can be used like a mouse for navigation and to enter text either to be stored as handwriting (or "digital ink") or to be converted into computer text. The shapes of the Tablets range from notebooks modified to allow the display to fold flat for writing to true tablets that have no real keyboard except when placed in a dock. I'll take a closer look at the hardware from Acer, Fujitsu, Hewlett-Packard, and Toshiba next week.

For now, though, I want to focus on the new capabilities delivered by the Tablets. I found it was neat for a while to watch a PC turn my handwriting into text—getting about 9 out of 10 words right. But actually, that gets old pretty fast. And while storing handwritten notes, drawings, and doodles in a computer has its uses, I don't think it's enough to make me run out and buy a \$2,000 Tablet PC. Most applications still deal in text, and for most people, a keyboard remains the most efficient way to get words or numbers into a computer.

The real strength of the Tablet—and what will determine whether there is a substantial market in its future—lies in the third-party applications being developed to take advantage of its unique abilities, especially the direct manipulation of objects on the screen. These in-

clude drawing programs from Corel and Alias|Wavefront; Zinio, a service that turns a tablet into a magazine reader; and an application from Franklin Covey that lets you write appointments and notes on screens that resemble its planner pages, then merge the data into Microsoft Outlook.

The Tablet's usefulness, however, is hindered by some decisions Microsoft made, especially in the way it built pen entry on top of the existing Windows. When you are navigating around a Windows screen using a mouse or a mouse substitute like a laptop touchpad, you need a cursor on the screen so that you know what you are pointing at. In Windows, this is usually an arrow.

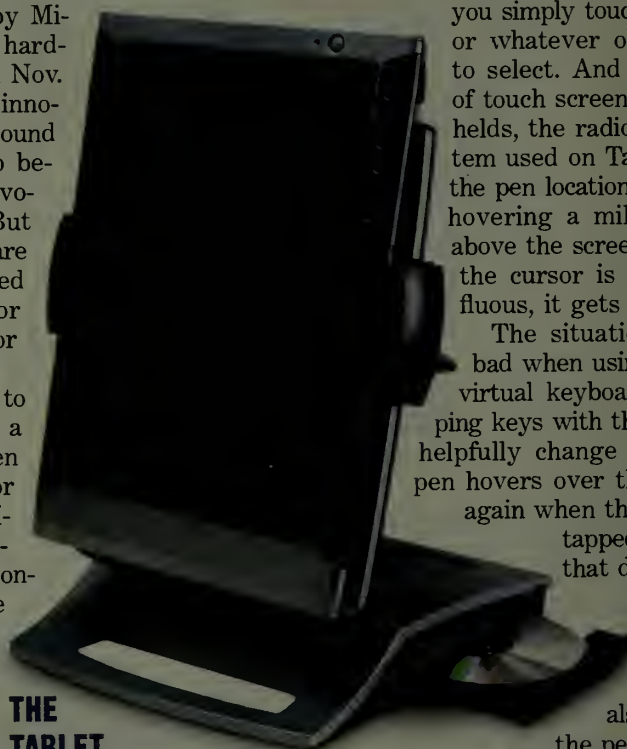
When using a Tablet with a pen, however, you simply touch the icon, text, or whatever object you want to select. And unlike the sort of touch screens used on handhelds, the radio frequency system used on Tablets will sense the pen location even if you are hovering a millimeter or two above the screen. In this setup, the cursor is not only superfluous, it gets in the way.

The situation is especially bad when using the on-screen virtual keyboard used by tapping keys with the pen. The keys helpfully change color when the pen hovers over them and change again when the key is actually

tapped. Unfortunately,

that distracting arrow follows you around like a Labrador puppy. There is

also no way to use the pen without a key-



THE TABLET

Its pen can be used both as a mouse and as a device to enter text

board to simulate the control-click and shift-click used to select multiple items in Windows. The tablet would be a wonderful way to use an image-editing program like Adobe Photoshop—if there were a way to emulate the shift, alt, and control keys the program uses extensively.

Using handwriting in place of the on-screen keyboard has its own problems. The software improves the accuracy of recognition by trying to interpret what you write in the context of the sentence. This works pretty well if you're dashing off an e-mail message. But it is disastrous for entering a user name, a password, or a Web address. (It had no trouble with "business week" written as two words, but consistently mangled businessweek.com.)

Little problems like this crop up throughout what is officially called Windows XP for Tablet PC. Cumulatively, they have a devastating impact on usability. For the time being, I think Tablet PCs will have limited appeal in specialized markets, such as insurance, where filling out on-screen forms is a major use. The rest of us can wait until Microsoft and its partners get it right.

BusinessWeek online

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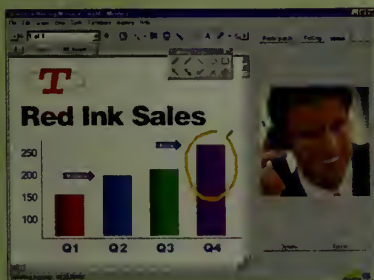
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"CRM in The Real-Time Enterprise is all about reducing costs, reducing delays, and bringing new revenue-generating opportunities into focus," says Davis. "Ultimately, it's the intelligent integration of complex technologies to make things simple."

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ABN AMRO uses PeopleSoft's CRM solution to drive new business within its customer base. "The PeopleSoft CRM pure Internet platform provides our customers, suppliers, and employees access to our Netherlands banking operations through any Web device, anywhere in the world, at any time," says Dolf Collee, ABN AMRO board member. "Employees now have a real-time comprehensive view of customers, making them more effective in resolving inquiries and acting on cross-sell and up-sell opportunities. Customers will have direct access to new products and services through multiple distribution channels resulting in more personalized service."

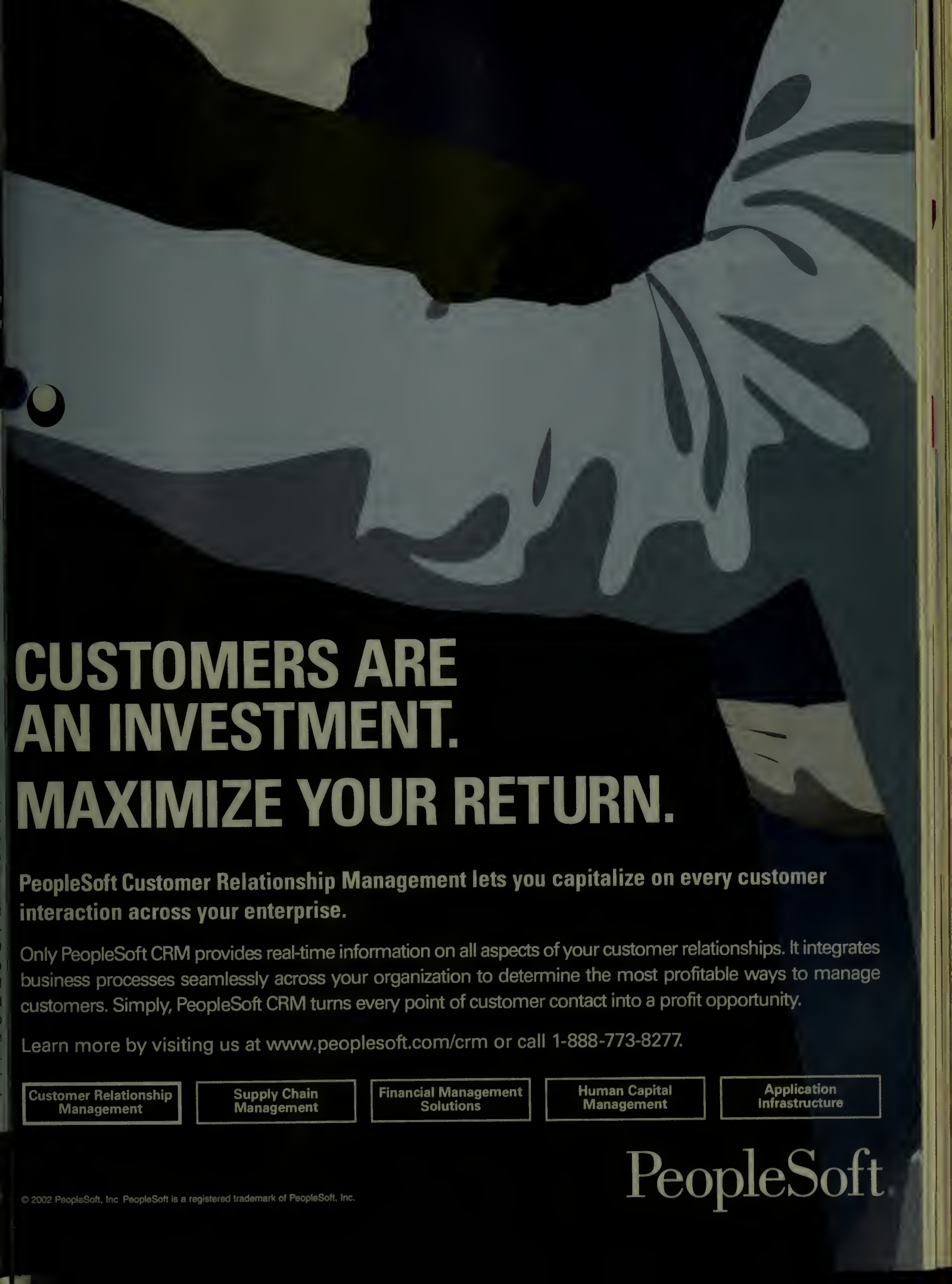
Fairchild Semiconductor's global internal and external sales teams use PeopleSoft Sales to maximize their selling opportunities. Fairchild employees and sales representatives around the world use PeopleSoft Sales to accelerate the sales process, influence buying decisions, and obtain real-time insight into opportunity information. "Now our salespeople have visibility into the most strategic opportunities," says John Henshaw, director of eBusiness, Fairchild Semiconductor. "And it allows our executive management team to see pipeline and competitive information, so they can make decisions in real time, based on information collected across the enterprise."

PepsiAmericas relies on PeopleSoft CRM and Order Management to combine customer information across its enterprise and give real-time access to its telesales agents. "PeopleSoft CRM gives a 360 degree view of our customers to the people in our enterprise who need it," says Ken Johnsen, PepsiAmericas Vice President and Chief Information Officer. "The Internet architecture is easy to deploy and that not only helps us lower our cost of ownership—it is also helping us get closer to our customers." As a result of operating in real time, PepsiAmericas not only knows its customers much better, but also has lowered costs by streamlining deliveries and enhancing customer satisfaction—ultimately increasing its competitiveness.

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BY ROBERT KUTTNER

SO MUCH FOR CRACKING DOWN ON THE ACCOUNTANTS



BIG SHAM:
Pitt is gone.
But the saga
of Webster's
appointment
is strong
evidence
that the audit
industry and
the Bush
Administra-
tion are bent
on evading
reform

Securities & Exchange Commission Chairman Harvey L. Pitt's bungling of William Webster's appointment to head the new accounting oversight board has produced bipartisan incredulity. Pitt's failure to tell his SEC colleagues of Webster's possible role in auditing irregularities at U.S. Technologies Inc. certainly justified Pitt's resignation on Election night, but it should not obscure the larger stakes. At bottom, the issue is this: Will the accounting industry be permitted to resume its practice of regulating itself almost as if the recent scandals had never happened? Or will strong oversight and regulation apply, as intended by the Sarbanes-Oxley Act?

Every investor ought to be appalled by the attempt of the accounting industry and the White House to reverse reform by stealth. What practical difference does it make if the board is headed by a William Webster or by a truly independent and expert figure such as former TIAA-CREF chief John H. Biggs? Webster, according to well-placed SEC sources, lacks the technical expertise that the job requires and was intended by his sponsors to be an ally of the accounting lobby. A Webster-style board would likely allow the accounting industry to revert to the weak self-regulation that failed to prevent the fraudulent audits, bankruptcies, and stock market calamity of recent months.

Whoever eventually heads it, the board faces four key regulatory issues that will determine its success or failure: auditing standards, internal quality controls for accounting firms, disciplining of accountants, and the independence of auditors from clients. The new act specifies nine categories of prohibited activities, but the board must precisely define them and set up detailed enforcement systems. A key issue is whether the board should rewrite the rules that prescribe how far an audit must go to look for fraud or accept the current rules composed by the profession's trade association, the American Institute of Certified Public Accountants.

Unlike the banking industry, which is policed by government regulators, accounting has historically governed itself through professional standards and peer-review systems. As the serial scandals revealed, these were often a joke. The AICPA spent only a few million dollars a year on self-policing. Short of being caught red-handed stealing clients' money, accountants were rarely disciplined. Industry peer review failed to prevent palpable conflicts of interest. The nominally independent Financial Accounting

Standards Board (FASB) defines accounting and auditing standards. But the crucial governance task was actually delegated to the industry's own trade association, the AICPA. A 2000 report by the industry's Audit Effectiveness Panel, for example, presciently concluded that standards for detecting fraud in an audit were seriously inadequate. But the industry successfully resisted strengthening the standard to what the panel recommended.

The Sarbanes-Oxley bill aimed to change all that. It gave a new independent board statutory authority to define and enforce its own standards, along with a budget expected to exceed \$100 million. But the accounting industry, through the AICPA and its longtime advocate Pitt, resisted tough legislation. When public outrage forced even Republicans to support a strong law, the accounting industry then fought a rearguard action to weaken the act's implementation and lobby for a tame panel that would once again adopt AICPA procedures as its own.

Although Pitt has denied it, my sources confirm that he indeed had offered the job to Biggs. Biggs, a serious critic of accounting practices, said that the board should write its own rules rather than just taking what the AICPA gave him. My SEC sources say Pitt hoped that other appointees on the oversight panel would neutralize Biggs, but when word of his pending appointment leaked, accounting industry lobbyists, House Finance Services Committee Chairman Michael G. Oxley, and White House Chief of Staff Andrew J. Card sprang into action. Pitt soon rescinded the offer, and the White House produced 78-year-old Webster.

As former head of the FBI and the CIA, Webster is the sort of nominally independent figure to whom corporate boards turn to simulate public reassurance—without real independence. In addition to heading the audit committee for U.S. Technologies, Webster serves on several other corporate audit committees. But industry lobbyists widely expected him to be the tool of Pitt and of Pitt's political ally, SEC chief accountant Robert K. Herdman.

It's hardly surprising that business conservatives resist regulation of, say, health, labor, and the environment. You would think, though, that they would want to have honest corporate books. American capitalism works only to the extent that investors receive truthful information. The AICPA's behavior is scandalous, but the deeper scandal here is the myopia of political leaders who pose as champions of capitalism. ■

Robert Kuttner is co-editor of *The American Prospect* and author of *Everything for Sale*.



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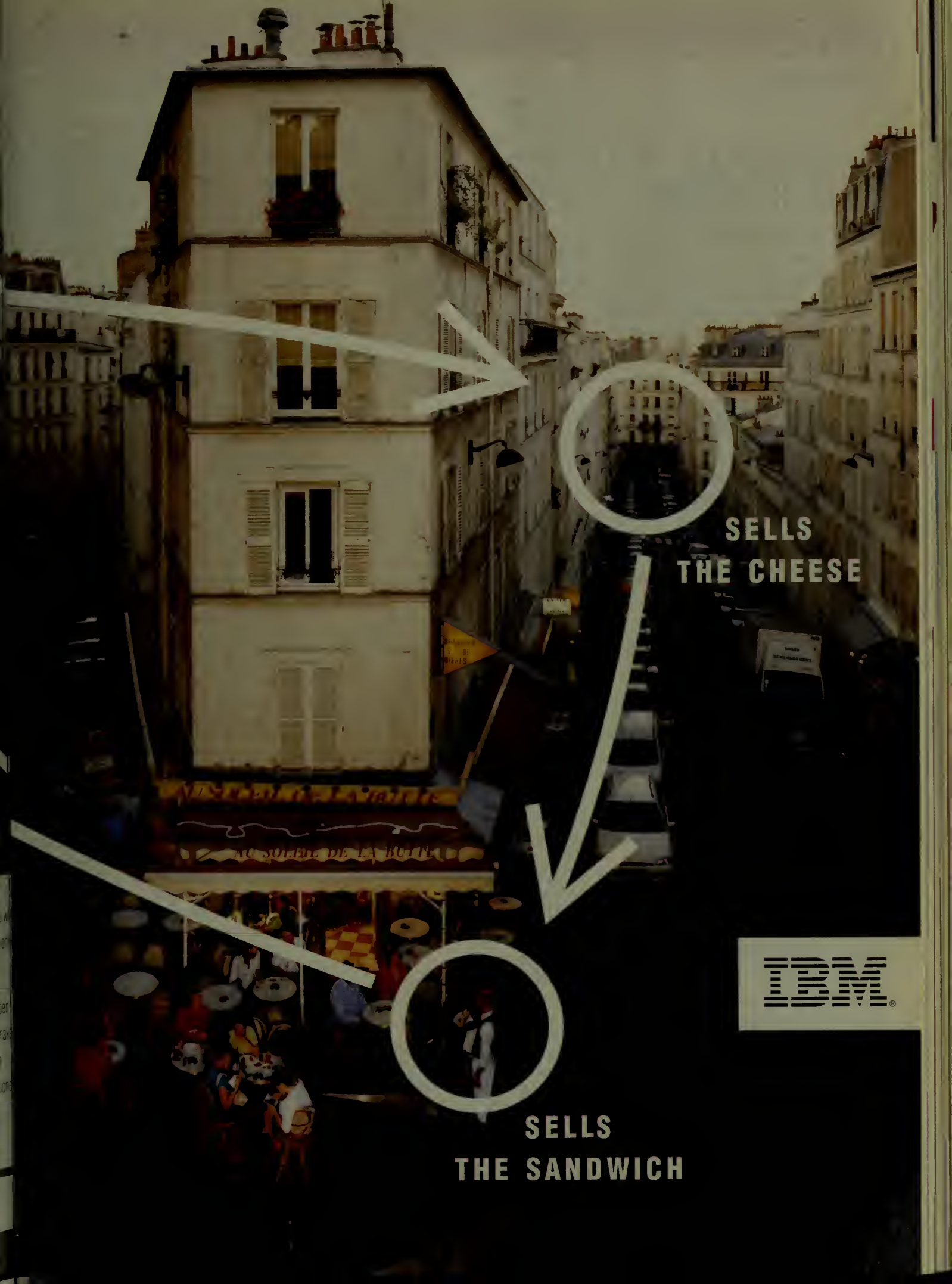


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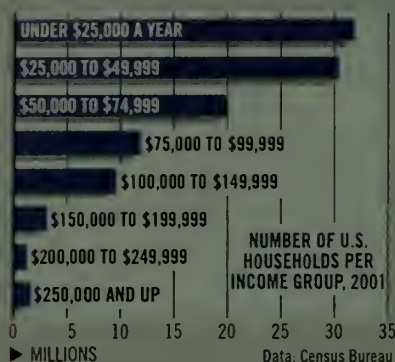
BY PETER COY

LESS CHANCE TO RISE IN LIFE

Income gaps are more persistent

While the U.S. prides itself on being the land of opportunity, economists have grown less optimistic about the ability of American children to leap ahead of their parents' station in life. A six-figure income remains beyond the grasp of all but 14% of American households (chart). And recent research has

INCOME BY THE NUMBERS



found a higher-than-expected correlation between people's position on the income ladder and the rung their parents once occupied.

In the 1980s, studies concluded that, on average, only about 20% of the earnings gap between any two people would persist a generation later as an earnings gap between their children. That would have indicated a society with lots of mobility. However, estimates were later raised to around 40%. Now, research by Bhash Mazumder, an economist at the Federal Reserve Bank of Chicago, concludes that fully 60% of the income gap in one generation persists into the next generation, on average. That would mean that children of poor families would tend to be poor as well.

Mazumder and others reach their more pessimistic conclusions by studying longer stretches of earnings history than in previous studies, thus filtering out chance fluctuations in income that temporarily gave children much higher or lower incomes than their parents. The lower level of mobility suggests that the rise in income inequality over the past two decades "may persist for several generations," says Mazumder.

What's the solution? Mazumder sug-

gests that more access to educational loans might help. He says many poor people who have children with great potential can't raise enough money to send them to good schools, so the children never take home the incomes they're capable of earning.

MONEY-MARKET MELTDOWN?

Low rates could spark an exodus

Remember those old submarine movies where rivets would start to pop as the sub dove too deep? Goldman, Sachs & Co. senior economist John Youngdahl worries that a few rivets in the financial system could pop if interest rates sink too far. He's concerned about money-market mutual funds, which hold more than \$2 trillion worth of safe, short-term financial instruments issued by nonfinancial corporations, banks, the Treasury, and loan buyers such as Fannie Mae. These funds didn't exist until the mid-1970s, yet today they account for one-quarter of M3, the broadest measure of U.S. money supply.

According to Youngdahl, money-market funds could lose a big share of their assets if the interest rates they pay keep falling. Today, money-market funds are among the biggest buyers of commercial paper from large companies such as General Electric, General Motors, and IBM. But if they lose assets, the funds won't be such aggressive buyers—and that could disrupt the flow of credit. The key question is whether banks and other suppliers of credit to corporations will step up rapidly to take the money funds' place.

There's little doubt that low rates are already harming money funds. This year, for the first time since 1985, money-market funds are likely to experience a net outflow. Their assets were down 3% through Oct. 22 after growing 24% last year, according to iMoneyNet Inc., a data collector in Westborough, Mass.

The danger is that banks, which are getting cash that used to be in money-market funds, may not recirculate it quickly enough by stepping up their business lending. "If there was a tidal wave of money moving into the bank deposit base, how would the banks deal with that, in rechanneling it back to the borrowers?" Youngdahl asks. Lately, banks have shown little appetite for the risks of corporate lending. In the past year, their commercial and industrial loans have fallen 8%, while their hold-

ings of Treasury and agency securities have risen 20%.

Many economists say there's nothing to worry about. They say banks have every incentive to lend out new deposits—and that corporate borrowing demand is so soft anyway, there's plenty of money to satisfy it. Then again, no one can be sure how the financial system will respond to the lowest interest rates of this era. Hmm...is that the sound of rivets loosening?

CHIPPING AWAY AT PAPER CHECKS

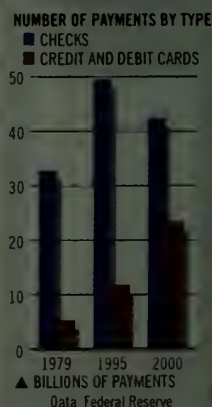
Congress gives e-versions a boost

In the age of the Internet, it's a little amusing and a little appalling that the U.S. financial system still depends on airplanes and trucks carrying boxes of paper checks from bank to bank. The Federal Reserve has been trying for years to reduce the use of costly, inefficient checks.

There's new evidence that it's finally beginning to succeed. The Fed reported recently that the number of checks written annually appears to have peaked sometime in the late 1990s. Although checks remain the most frequently used form of payment—accounting for 59% of payments, excluding cash and very large electronic transactions—credit and debit cards are rapidly catching up, rising from 18% in 1995 to 33% in 2000 (chart). There's also a growing niche for electronic payments between banks, such as direct deposit of paychecks and preauthorized payments of monthly bills. They accounted for 8% of payments in 2000.

The cost of processing paper checks could be eased by proposed legislation, supported by the Fed, that would give electronic versions of checks the same legal standing as paper ones. The initiative gained urgency after September 11, 2001, when the temporary paralysis of the transportation system threatened to bring the financial system to a halt as well. The legislation would give banks the option of not returning canceled checks to their customers in physical form.

FEWER CHECKS



BY JAMES C. COOPER & KATHLEEN MADIGAN

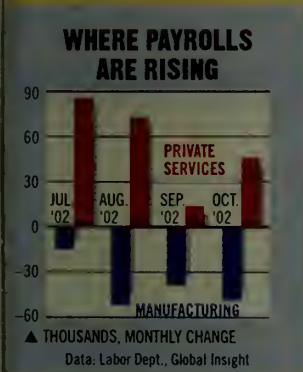
AFTER A SOFT FOURTH QUARTER, THE NEW YEAR SHOULD BE HAPPIER

The Fed takes out some insurance for a stronger economy in 2003

U.S. ECONOMY

The Federal Reserve is fed up with the toll that uncertainty is taking on the economy. That much was clear from the Fed's surprisingly aggressive half-point cut in interest rates on Nov. 6. While the move will do little to aid what promises to be a weak fourth quarter, it helps to lay the groundwork for stronger growth in 2003.

In a unanimous vote, the Fed reduced its overnight federal funds rate to 1.25% and said pointedly that "greater uncertainty, in part attributable to heightened geopolitical risks, is currently inhibiting spending, production, and employment." The action appeared to be aimed directly at shoring up business' confidence in the future. But it may be a one-shot move, since the Fed also said the balance of risks in the outlook were no longer skewed toward economic weakness.



The Fed did recognize that the economy is in a "soft spot" this quarter. However, if you look across the valley of the fourth quarter, the other side looks a lot brighter. That's especially true now because the Fed's bold action complements key economic fundamentals that will support growth in demand and output in 2003.

First, even before the Fed's latest move, businesses were starting to spend again. Third-quarter outlays for equipment rose faster than they did in the second quarter. And why not? Reports on both profits and sales last quarter were quite encouraging, and with productivity up and costs down, the outlook for further gains in earnings is improving.

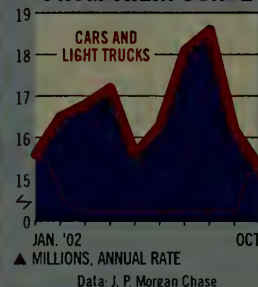
Second, consumers' spending potential continues to be supported by healthy income growth. Despite the overall somber tone of the October jobs report, employment losses remain concentrated in the manufacturing sector (chart). Also, a boost from the record refinancing wave has yet to show up in outlays, and the recent upturn in the stock market is an added plus.

CONSUMER FUNDAMENTALS may not look that robust in this quarter since household spending will be suffering from a loss of momentum coming out of the third quarter. Real gross domestic product rose at a 3.1% annual rate last quarter, and household spending on goods and services grew 4.2%, the strongest show-

ing of the year. But the monthly pattern showed the gains were front-loaded in the quarter. Spending rose 0.9% in July, faded to a 0.2% increase in August, then fell 0.6% in September. An expected post-incentive crash in car sales accounted for much of the slowdown, but spending on other items tended to trail off as well.

Consequently, spending began the fourth quarter in a deep hole, especially since October car sales fell to an annual rate of 15.3 million after averaging 17.6 million in the third quarter (chart). Even if outlays grow a solid 0.3% or 0.4% in both November and December, household spending will struggle to provide any lift at all to fourth-quarter economic growth. That's the chief reason why growth in real gross domestic product this quarter will look weak.

VEHICLE SALES RETREAT FROM THEIR SURGE



However, just as the third quarter's strength was front-loaded, the fourth-quarter's weakness may be front-loaded as well. That would indicate an improving performance heading into 2003. For one thing, past trends in mortgage applications and stock prices suggest that the refi boom and the market rally—assuming it holds up—will boost spending in coming months.

Also, recent data do not suggest that consumers are overextended, even after record sales of homes and cars. At the annual conference of the Global Interdependence Center on Nov. 4 in Philadelphia, Bruce Kasman, chief U.S. economist at J.P. Morgan Chase & Co., noted that consumer spending on durable goods and housing as a share of GDP was 13% in the third quarter. That's close to the long-term average of 12.7% and well below the nearly 15% share hit after the recessions in the 1970s and 1980s.

BUT THE MOST IMPORTANT SUPPORT to future consumer spending will be income growth. Real after-tax income advanced at an annual rate of about 3% in the second and third quarters, even with no job growth. And in October, average hourly pay of production workers was up 0.2% from September. Companies are able to grant wage increases that are still running ahead of inflation because they have continued to increase the productivity of their workforce.

The downside of those efficiency gains is that busi-

nesses are expanding output without adding people. Indeed, in the first three quarters of this recovery, productivity gains have accounted for twice as much of the advance in economic growth compared with the average experience in the previous nine recoveries.

Nevertheless, while job markets are stagnant, they are not getting worse. Payrolls posted tiny declines in both September and October, but they are higher now than six months ago. Since April, manufacturers have shed nearly 200,000 jobs, but payrolls of private-sector service companies have grown by almost 300,000. And although the October jobless rate edged up to 5.7%, from 5.6%, unemployment claims through October headed downward. If the jobless rate holds steady in November, consumers may grow more confident about the economy's future.

THE BUSINESS SECTOR, however, is where uncertainty about the future has caused the most trouble, and manufacturers have felt the hardest blow. Factory output began falling in August and probably declined again in October, based on the dip in the Institute for Supply Management's index of industrial activity to 48.5%, from 49.5% in September. A reading below 50%, means the sector is contracting.

But even in manufacturing, there are signs of future improvement. The ISM's index of new orders popped above the 50% level for the second month in a row.

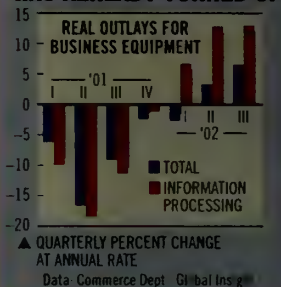
Also, businesses continued to buy more equipment. Outlays for items such as computers, turbines, and forklifts rose at an annual rate of 6.5% in the third quarter. Spending on information-processing gear alone increased 13%, the third consecutive advance (chart).

Business sales and profits are gradually starting to pick up. Third-quarter overall demand in the economy, adjusted for inflation, rose 2.4% from a year ago, the best annual showing in nearly two years. And that occurred at a time when rising productivity and falling unit labor costs allowed companies to earn more on each unit of product they sell.

As a result, when the Commerce Dept. reports its accounting of third-quarter corporate profits on Nov. 26, look for a strong gain that will provide the funds necessary to finance further equipment outlays and hiring.

That good news may not resonate much if investors are focused on forecasts of dismal fourth-quarter GDP growth. But what's important to keep in mind is that the fundamentals—plus some extra insurance from the Fed—argue that the economy will strengthen over the next few months, and it will head into 2003 with more momentum than it has right now.

EQUIPMENT SPENDING HAS ALREADY TURNED UP



JAPAN

WIDESPREAD WEAKNESS SPELLS MORE JOB CUTS

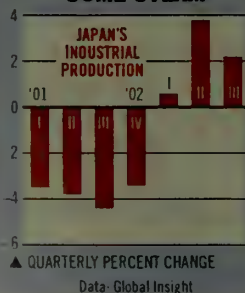
Japan's watered-down effort at bank reform has dominated the news in recent weeks, but the economy also has another problem: It's close to stalling out, reflecting falling exports and weakness in domestic demand that shows few signs of improving anytime soon.

Besides the 3.6% third quarter drop in exports, the lack of business investment keeps weighing on factory output. Early September data show industrial production slipped 0.3% from August. That put third quarter output up 2.1%, slower than the 3.8% pace in the second quarter (chart). Output estimates and sentiment among small and medium manufacturers point

to an even slower fourth quarter.

Also, a depressed real estate market and government belt-tightening are hurting construction, with political pressure rising for a supplemental budget.

FACTORIES LOSE SOME STEAM



naka has in taking meaningful action on bank reform, the more joblessness will rise. Still, even if reforms grind to a halt, the likelihood of unemployment topping its record level of 5.5% is growing.

The widespread weakness means more job cuts ahead. September payrolls fell by 30,000, with construction losing 120,000 jobs. The service sector remains the only source of job growth. And the more success that top bank regulator Heizo Take-

That's bad news for consumers, who have shown some signs of life. Spending has improved gradually since the spring, despite declines in real income, which was down 1.2% from a year ago in September. But, the Bank of Japan doesn't see deflation ending in 2003, and given unemployment fears, consumers could once again put off major purchases knowing prices will be cheaper later on.

Growth this quarter could be zero. But the BOJ says the economy should pick up again next spring, with real gross domestic product growing 0.4% to 1% for the fiscal year starting next April. Exports are expected to lead the way, lifting domestic demand. However, structural problems and a slow-moving government leave doubts about a turnaround.

By James Mehring in New York

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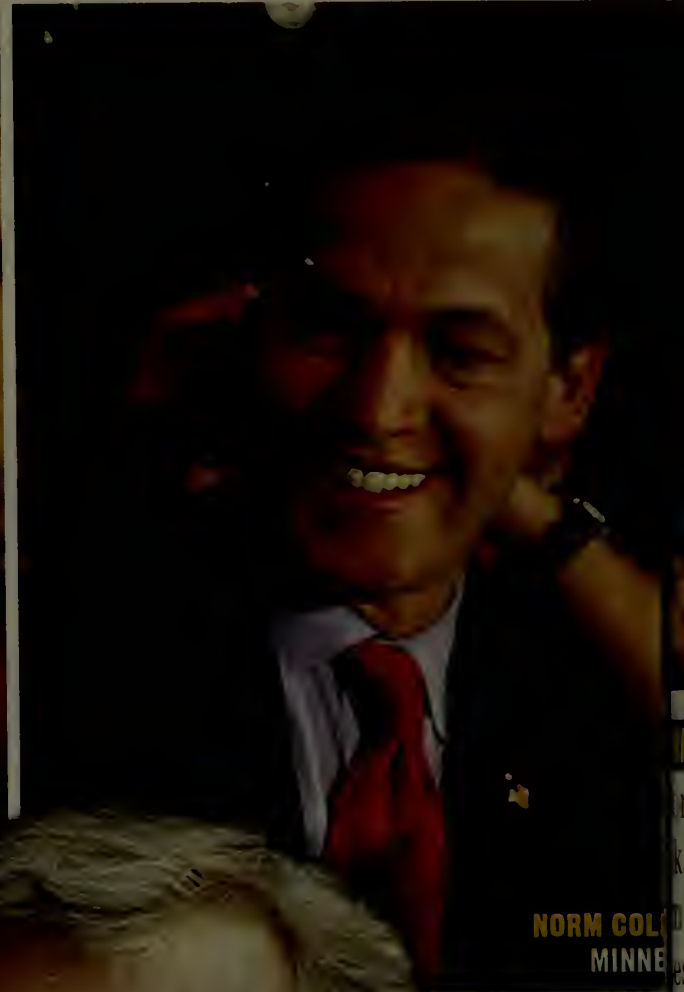
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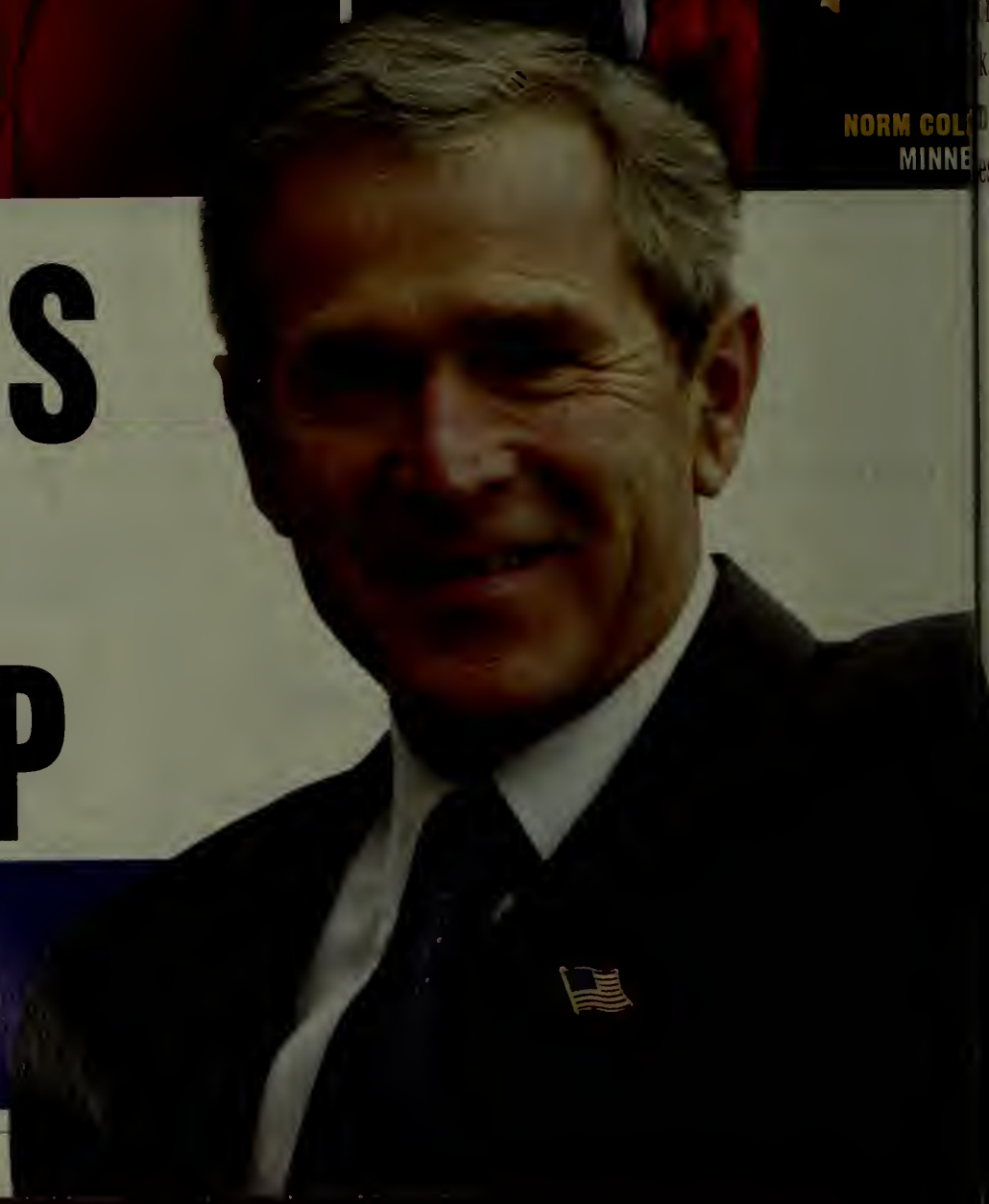
ELIZABETH DOLE NORTH CAROLINA

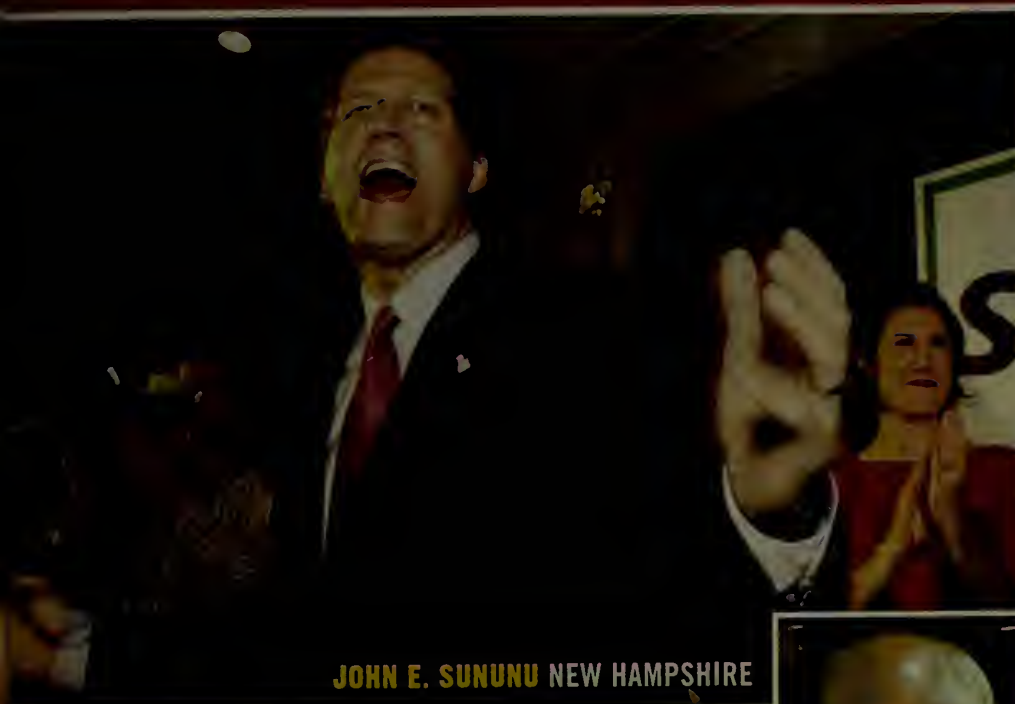


NORM COLEMAN MINNESOTA

BUSH'S BIG SWEEP

The barnstorming President gets a new mandate. But there's no cakewalk ahead





JOHN E. SUNUNU NEW HAMPSHIRE

NATE EDGE Bush carried most of his endorsed candidates to victory after a final-week, 15-state campaign blitz. Among them were his handpicked choices in states such as Minnesota and Georgia



SAXBY CHAMBLISS GEORGIA

THE NEW BALANCE OF POWER

Senate Seats

	OLD	NEW*
DEMOCRATS	50	46-48
REPUBLICANS	49	51-53
INDEPENDENTS	1	1

* SOUTH DAKOTA AND LOUISIANA UNDECIDED AT PRESS TIME

House Seats

	OLD	NEW*
DEMOCRATS	208	203-207
REPUBLICANS	223	227-231
INDEPENDENTS	1	1

*SEATS IN NEW YORK, TEXAS, COLORADO, AND LOUISIANA UNDECIDED AT PRESS TIME

Statehouses

	OLD	NEW*
DEMOCRATS	21	22-25
REPUBLICANS	27	25-28
INDEPENDENTS	2	0

*OREGON, ARIZONA, AND ALABAMA UNDECIDED AT PRESS TIME

It was an election with almost no political downside for a President riding high in the polls. If Republicans suffered setbacks in the Nov. 5 elections, the White House was ready to blame the midterm curse that afflicts virtually all rookie Commanders-in-Chief. But George W. Bush decided to roll the dice. He put his prestige and record-breaking job-approval ratings on the line and set out on frantic cross-country visits to key swing states.

The result was a narrow but decisive sweep of Capitol Hill. The Senate will now have a minimum of 51 Republicans, with at least 46 Democrats and 1 Independent. Louisiana Democrat Mary L. Landrieu faces a Dec. 7 runoff with Republican Suzanne Haik Terrell. And as *BusinessWeek* went to press on Nov. 6, a recount was likely in the race between incumbent Democratic Senator Tim Johnson of South Dakota and challenger John Thune. The GOP, meanwhile, had a 227-203 edge in the House, a gain of at least three seats, with four races still undecided at press time.

The election was a historic victory for Bush, who became only the fourth President since the Civil War to gain House seats at midterm. "This election

puts Bush in the driver's seat to accomplish a number of things on the business front that he would never have imagined," says Steve Grossman, a former Democratic National Committee chairman and CEO of MassEnvelopePlus, a Massachusetts graphics company. Among the top priorities on which Bush will have added clout: tax cuts, tort reform, and confirmation of conservative federal judges. But even with a new mandate, he won't have time to gloat. Awaiting him: a possible war with Iraq and a slumbering economy.

The showdown with Saddam Hussein clearly helped Republicans in the closing days of the campaign. Bush, who visited 15 states during a final-week blitz, ended up carrying almost all of his endorsed candidates to victory. Among them: hand-picked Senate challengers in Missouri, Minnesota, and Georgia.

The evening brought a few disappointments, of course. Democrats swept to the governorships of several key Presidential battleground states, including Pennsylvania, Michigan, and Illinois, complicating the White House strategy for Reelection 2004. Still, the statehouse triumphs did little to cheer Dems. Unable to turn the weak economy to their

(CLOCKWISE FROM TOP LEFT) PHOTOGRAPHS BY ROBERT PAGETT/REUTERS; BILL ALKOFER/GETTY IMAGES; JON PIERRE LASSEIGNE/AP/WIDE WORLD; ERIK S. LESSER/AP/WIDE WORLD; RON EDMONDS/AP/WIDE WORLD

advantage (page 38), they are already pointing fingers (page 40).

As Democrats try to figure out what went so wrong, Bush has to get back to business. The denouement with Saddam is fast approaching (a U.N. vote was scheduled for Nov. 8), and a teetering economy demands his attention.

In addition, Bush must swiftly hammer out final deals with Congress on terrorism insurance and homeland security. He must find common ground on long-debated energy legislation. And he will at least try to break the partisan gridlock over a prescription drug benefit for seniors and judicial nominations. Finally, the Administration will have to decide whether to tackle two long-term priorities: tax reform and the troubled Social Security system.

That's a hefty to-do list for any President, especially one without a solid majority in either house of Congress. Because 60-votes are necessary to accomplish almost anything in the Senate, passing major legislation will require lawmakers to reach across the aisle. "The Senate was designed by our forefathers to be very slow and difficult to move, and boy have they succeeded," says incoming Senate Majority Leader Trent Lott (R-Miss.).

Hurdle One for the President is that, for a while at least, his top two goals—jump-starting the economy and ending the reign of Saddam—could be incompatible. So far, war jitters are sapping corporate and consumer confidence, prompting Bush advisers to worry that the economy could stall. Consumer confidence cratered in October, plunging to a nine-year low. Auto sales during the

NANCY JOHNSON
CONNECTICUT



month fell to their lowest level in four years despite incentives. And October chain-store sales were "dismal," says Bank of Tokyo-Mitsubishi senior economist Michael P. Niemira.

The drums of war are also giving already risk-averse corporate chieftains another reason to hold back on spending and hiring in a bid to boost paltry profits. Capital-goods orders tumbled more than 4% in October, while private payrolls shrank by 29,000. And the manufacturing sector looks to have fallen back into recession. According to a survey by the Institute for Supply Management, manufacturing contracted in October for the second straight month. Says Allen Sinai, chief global economist for consultants Decision Economics Inc.: "We're going to see a very poor fourth quarter and a bad Christmas. It's very, very dicey." Other economists are also sharply reducing forecasts for fourth-quarter growth. Many now see growth of 1% or less, vs. 3.1% in the third. First-quarter 2003 forecasts are being pared, too, in some cases to as little as 1%.

That won't make for pleasant reading as the President decides whether to go to war with Iraq this winter. With growth so weak, the economy is vulnerable to external

HISTORIC HOUSE Bush is only the fourth President since the Civil War to gain House seats in a midterm election. But with the threat of war and a weak economy, he won't have much time to gloat

shocks, like a spike in oil prices. In a sign of how worried policymakers are, the Federal Reserve cut interest rates by a larger-than-expected 50 basis points on Nov. 6.

Bush advisers realize that they must do more to convince the public they are acting decisively to turn around the economy. "They know the economy is the thing that will win or lose the election two years from now," says Geoff Kemp, a director of the Nixon Center and a National Security Council official in the Reagan Administration.

That's why a third stimulus proposal from the two-year-old Administration is a sure bet. Among the most likely components: an acceleration of the 2001 tax cut, an extension of unemployment benefits scheduled to expire on Dec. 28, and an increase in the minimum wage. The package could also include some

The 2003 Agenda

HOMELAND SECURITY Pressure will build on Dems to support the President's version of a new Homeland Security Dept. One reason: Two Senate Democrats lost their seats after opponents attacked them for blocking creation of a new agency.

IRAQ The possible war against Iraq could dominate the policy agenda well into the spring, complicating efforts to revive the economy. But the Republican sweep of Capitol Hill strengthens the President's hand as he tries to persuade the U.N. to take a hard line against Saddam.

ECONOMIC STIMULUS Policymakers agree the sluggish economy needs a fiscal jolt. Agreement on how to provide one is another matter. The House will push for a new round of tax cuts. Congressional Democrats will want to extend unemployment benefits and aid to hard-pressed states.

TAXES Bush will start laying out principles for broad tax reform, but don't look for any action in Congress next year on anything more than incremental measures. A White House advisers remain fearful of breaks for business

fiscal relief to hard-pressed state governments and at least \$30 billion in new Medicare payments to doctors, hospitals, and nursing homes.

But the top tax priority will be to make the 2001 tax cuts permanent, a step that would repeal the estate tax. This politically popular proposal has the added benefit of not increasing the short-term deficit, but it would cost \$4 trillion in the decade following 2010, when the current law is due to expire.

The prime mover behind the stimulus package is chief White House economic adviser Lawrence B. Lindsey, who fears an unemployment rate of 7% by 2004 if action is not taken to boost consumption and the stock market. The White House is planning to market the proposal as recovery insurance. "I still believe we're on the glide path to expansion, but the timing is uncertain, particularly on the investment side," says Glenn Hubbard, chairman of the President's Council of Economic Advisers. "Do we want insurance or not?"

The answer from most quarters of Corporate America is a resounding yes. "There has to be some stimulus package," says Vanguard Group founder John C. Bogle. "I would say we need tax breaks that favor middle-income people to stimulate spending."

However, says David F. D'Alessandro, chairman and CEO of John Hancock Financial Services Inc.: "I don't think Congress can do anything to help the [\$10 trillion] economy very dramatically. There are no silver bullets that I can see."

Lindsey's possible departure would eliminate one loud voice for a big stimulus package of tax cuts. What's more, Treasury Secretary Paul H. O'Neill, Commerce Secretary Donald M. Evans, and White House budget director Mitch Daniels caution that there is not enough money available now to do everything Republicans have proposed.

The money may not be there, but the President campaigned this fall to repeal the inheritance tax and make the 2001 cuts permanent. Bush aides expect the proposals to be the White

Right Face

With Republicans in control of the Senate, the players leading key committees will be decidedly more conservative. Here's the new lineup:

FINANCE CHARLES E. GRASSLEY (R-IOWA)

A tax cutter and fiscal conservative. His top goal: make last year's tax cuts permanent. He supports corporate tax breaks but is quick to crack down on abuses.

BUDGET DON NICKLES (R-OKLA.)

A deficit hawk, he'll seek to restore surpluses by keeping spending in line. But he'll push for permanent tax cuts, and Bush can count on him to back a stimulus plan.

BANKING RICHARD C. SHELBY (R-ALA.)

He'll look to restore market confidence by keeping tabs on accounting reform. May seek to increase corporate and audit-firm liability in investor fraud suits.

COMMERCE JOHN MCCAIN (R-ARIZ.)

A deregulator, but he won't be swayed by corporate influence peddling. Look for him to inject spending discipline into a pork-laden highway bill up for renewal in '03.

ENVIRONMENT AND PUBLIC WORKS

JAMES M. INHOFE (R-OKLA.)

He'll carry water for the White House on environmental regs, and ignore enviros' pleas to regulate carbon dioxide emissions. Business can breathe a sigh of relief.

House's top tax priority in 2003. And while anti-tax conservatives also are pushing for an end to the corporate income tax and double taxation of dividends, Administration officials fear the wrath of voters angry about boardroom corruption. "Can you imagine rewarding Corporate America for the year we had in '02 by killing the corporate income tax in '03?" one Bush adviser asks. "Politically, it's deadly."

Efforts to create a new Medicare prescription drug benefit may fare better. A tripartisan group of lawmakers already is preparing to renew efforts to enact one next year, at a cost of roughly \$300 billion to \$400 billion over 10 years. While budget constraints and

Presidential politics could stymie reforms, the White House is anxious to get credit for passing what has always been seen as a Democratic initiative. "There'll be a major push to get that done," says one Bush insider.

Congress will also have to tackle two other big-ticket issues next year: welfare reform and a massive new transportation bill. Laws on public assistance and funding for construction of roads, bridges, and airports expire soon and must be renewed. Daniels is already signaling that the Administration will resist costly new projects. Spending "is going to have to increase slowly, if at all," he says.

Bush also is likely to wage a guerrilla war with his most powerful political enemies, the trial lawyers who spent tens of millions of dollars trying to elect a Democratic Congress. The Administration is readying a series of proposals to limit legal claims against

businesses. While some House GOP leaders, such as Representative Tom DeLay (R-Texas), long for a broad tort-reform bill, White House and business strategists want to enact narrowly targeted limits on lawsuits. Their reasoning: Business does not have the 60 votes needed to stop a Senate filibuster of a comprehensive lawsuit-reform bill, but it could roll back jury awards piecemeal.

The first step came last year when Congress shielded teachers who use corporal punishment from lawsuits. Next up: Proposals to limit pay-outs in medical malpractice suits and curb asbestos litigation. "Questionable lawsuits are threatening up to 90% of our economy," says Conoco Phillips Chairman Archie

HEALTH CARE Washington will try again to enact a new prescription drug benefit for seniors, although there is plenty of disagreement over the details. Odds of passage improved as a result of the GOP victory. In addition, \$30 billion in Medicare payments to doctors, hospitals, and nursing homes.

LEGAL REFORM While some Hill Republicans favor broad-based reform, the White House and many business groups prefer targeted limits on lawsuits. Legislation on medical malpractice and asbestos litigation could gain traction.

SOCIAL SECURITY Although the White House insists Bush still wants to overhaul the system, the issue of partial privatization is dead until after the 2004 election. Dozens of GOP candidates repudiated the President's proposal to create individual retirement accounts.

WELFARE The welfare-reform law and the multibillion-dollar highway-construction act are both about to expire. Republicans and center-right Democrats will try to further tighten welfare rules. Bush will battle lawmakers in both parties to rein in spending on roads and bridges.

Dunham, chairman of the National Association of Manufacturers.

Business is less likely to see progress on two other major issues—tax reform and an overhaul of the Social Security system. While Bush is expected to lay out a series of principles to overhaul federal taxes, aides say he won't push for their adoption until a second term.

Bush's economic team has been discussing tax-reform options for months. No decision has been made on whether the President should tilt in the direction of a simpler income tax or go all-out for a consumption-based system.

Full-metal-jacket reform carries enormous risks. For instance, a true, low-rate flat tax would eliminate hugely popular tax breaks for homeowners and for workers who get employee health insurance. And repealing the corporate income tax, as O'Neill prefers, would be political dynamite so soon after the nation was rocked by business scandals. "Bush's tendency, left to his own devices, would be to throw deep and go for tax reform," says one White House adviser. "But the political people want to put it off until the second term."

As a result, Bush may take some tiny steps towards reform. He is likely to propose a series of initiatives to simplify provisions of the existing tax code. For instance, he is expected to call for a uniform set of rules to govern contributions and withdrawals from the dozen-plus retirement plans that now clutter the IRS rulebook.

ALTERED STATES

Bush helped long-shot Sonny Perdue win the statehouse in Georgia. But Dems won governorships in Pennsylvania, Illinois, and Michigan—all key to Bush's reelection in 2004

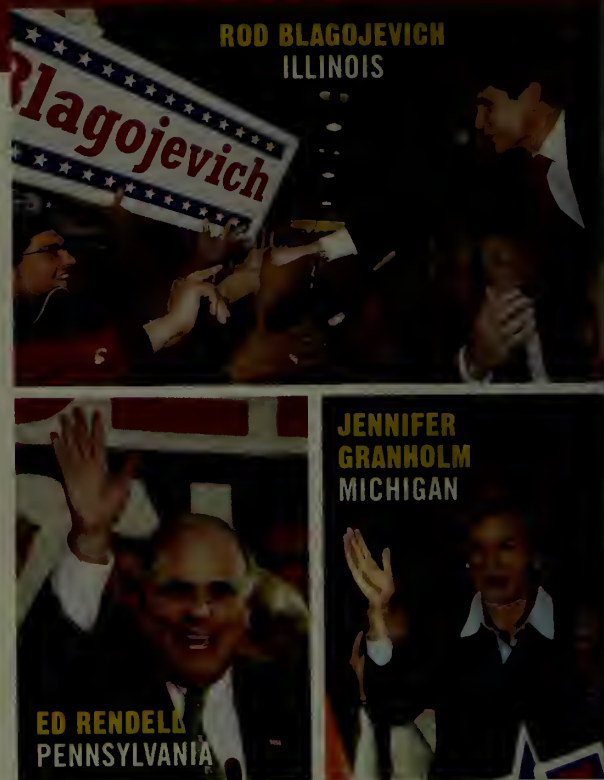
While tax reform still has political life, the idea of restructuring Social Security is on life support. Dozens of Republican candidates repudiated the President's proposal to create individual investment accounts. And the return of deficits means that there is no money to cover the estimated \$1 billion cost of a transition to partial privatization.

If the President wins a second term, though, Social Security reform and tax simplification could again be part of his domestic program, which started so promisingly with tax cuts

and school reform and then stalled.

The Bush agenda now has a new opportunity—but it won't come cheap. While Republicans will control Washington, they'll also be under the gun to deliver an economic turnaround. If they pull it off, they can look forward to an even giddier Election Night 2004. If not, there won't be much room for excuses.

By Richard S. Dunham and Howard Gleckman, with Rich Miller and Lorraine Woellert, in Washington; Amy Barrett in Philadelphia; William C. Symonds in Boston



MOSTLY SAYING NO TO CHANGE

This year's state ballot initiatives proved that voters were unwilling to spend tax dollars on anything but essentials. From universal health insurance in Oregon to improved transportation in Virginia, voters gave a resounding thumbs-down. "When there's a lot of uncertainty about the economy," says M. Dane Walters, president of the nonpartisan Initiative & Referendum Institute, "people lean toward maintaining the status quo."

There's one exception to that rule: education. Californians approved a measure that will allocate more than

\$500 million for before- and after-school programs. Arnold Schwarzenegger sponsored the initiative in what many observers saw as a precursor to a possible 2006 gubernatorial bid.

A tight-fisted mood yielded only to votes for smaller classes and more school programs

Floridians, meanwhile, voted to reduce class sizes and offer prekindergarten programs for four-year-olds. Parents, says Amy Wilkins of the advocacy group Education Trust, "will ask for better services even when resources are tight."

Voters were less inclined to tinker with drug and health policies. In addition to rejecting universal health insurance, Oregon voters killed an

initiative that would have required labeling products sold or produced in the state that contained genetically modified ingredients. In both instances, industry spent lavishly to defeat the measures.

Medical marijuana also went up in smoke. Voters in four states turned down ballot measures that would have relaxed drug laws, including one in Nevada that would have decriminalized possession of up to three ounces of marijuana. Cigarette smokers got scant consolation on election night. Floridians voted overwhelmingly to ban smoking in most indoor spaces. And Arizonans imposed a big tax hike on tobacco, although a similar measure lost in Missouri.

In years past, populist organizers, politicians, and lobbyists have used ballot measures to push for changes in social policies. This year, voters were in no mood to rock the boat.

By Alexandra Starr in Washington

[illegible]

You never know when opportunity will rise up and boldly say, "Hey, let's ski the Rockies this weekend!" It's times like these when the Citi® AAdvantage® credit card comes in handy. With no blackout dates on



COMMENTARY

By Lee Walczak

HOW BUSH OUTWITTED THE DEMS

As closely fought midterm campaigns went down to the wire, Republicans sensed that a subterranean tide might be flowing their way in the final days of Election '02. But when they awoke on Nov. 6 to discover that George W. Bush had just become the first U.S. leader since FDR to see his party sweep both House and Senate races in a by-election, something akin to euphoria hit the normally staid Bush Administration. Asked for his reaction to the bonanza, Budget Director Mitch Daniels said: "I wish it was [the movie] *Groundhog Day*. I wouldn't mind living this over and over."

No doubt about it, Republicans are cheering the Bush-led congressional romp and are relieved by the Democrats' failure to make good on a vow to capture a majority of the nation's governorships. Dispirited Dems, meantime, are bracing for a round of recriminations about the election that got away (page 40).

Despite a sickly economy, a brutal bear market, and the jolt of this summer's corporate crime wave, Democratic candidates couldn't hone an economic issue that would puncture President Bush's wartime armor—a failure that leaves veteran GOP pols incredulous. "Democrats never offered any positive economic vision for people to rally around," says Kenneth M. Duberstein, former chief of staff in the Reagan White House. "It was all negativism, wrapped around this great idea of freezing the [Bush] tax cut."

In fairness, Dems faced significant obstacles this election. Pro-

pelled by the war on terrorism, Bush's popularity hovers at around 63%—a lofty level for a leader at midterm. In race after race, the Dems were massively outspent by business-backed GOP candidates and diverted by a relentless White House focus on national security.

Still, as the postmortems are readied, one question looms above all others: How could the Democrats have let Bush dance away from an economy that feels this rotten—an economy in which consumer confidence has plunged to the lowest levels in nine years and workers' retirement accounts are evaporating?

The answers are many, but few offer much solace for Democrats dreaming of future campaigns. The most obvious conclusion is that with Bush at the bully pulpit and opposition leader Al Gore in hiding, the Dems lacked both a clear economic message and a strong messenger. What's more, a nimble Administration's "lock up the crooks" response to accounting

scandals shielded Republicans from backlash over corporate crime. Finally, there's the jobless issue—or lack of it. With the economy pulling out of a shallow slump, pre-election unemployment topped out at a mere 5.7%. That compares with a 10.8% peak in the 1981-1982 downturn—too small to stoke partisan rage.

But some who delve deeper into the Dems' poor showing divine a more disquieting trend: Far from having no message for economic revival, as critics allege, Democrats may have come up with one that misread both the currents of the New Economy and the sentiments of the nearly 50% of Americans who have stock

holdings and make up the Invest Class.

Talk of federal safety-net programs may be boffo with minority Democrats and a dwindling cohort of New Democrats, but it does not resonate with swing voters in the 'burbs. Neither does a response to corporate malfeasance that stresses stiff regulatory constraints over market-based solutions.

Maybe it's an accident, maybe not. But in a Pew Research Center poll taken just days before the election, the suburbs were breaking publican by 51% to 42%. Self-described investors favored the GOP 48% to 32%. And college graduates—up for grabs a month earlier—gave Republicans the point edge. "Look at what Democrats talked about in this campaign," says Mike McKeon, a Democratic pollster in suburban Illinois. "It was all 'Put America back to work, extend unemployment benefits, provide health care for laid-off workers.' That's a message for a Smokestack America that no longer exists, not an Information economy where workers constantly lose and find jobs—and some [chuckle] forego health insurance for considerable periods."

In McKeon's analysis, politicians

Bush by the Numbers

JOB APPROVAL

APPROVE	DISAPPROVE
62%	36%

ECONOMIC STEWARDSHIP

APPROVE	DISAPPROVE
54%	43%

REELECTION IN '04

Will definitely vote for Bush	46%
Will definitely vote for someone else	30%
Will consider someone else	21%

Data: Ipsos-Reid/Cook Political Report Poll
Oct. 29-Nov. 3. Based on a survey of 1,001 registered voters, with a margin of error of +/-3.1%





EASY SELL Unlike P candidates, who erred a growth agenda, the Democrats can't give suburban voters a positive economic vision

enate Democratic Leader Tom Bliley (D-S.D.) persist in thinking American voters will reflexively turn to economic hardship the way they say, Brazilians just did—by lurching to the left. Instead, any impulse to turn out may be tempered by the fluidity of the New Economy labor market—frequent job shifts are a fact of life for many Knowledge Economy workers—and by Americans' growing skepticism about investing and the economic climate. That's more, Bush's Republicans, by picking up such stalled GOP initiatives as terrorism-insurance bill, tort reform, production-friendly energy plan,

stumped for a "growth agenda" that offered an alternative vision of the economy sharply at odds with the Democrats' government-intensive approach. The result, if not a clear mandate for Bushonomics, was something almost as good for Republicans: stalemate over competing economic philosophies.

The upshot on Election Day: "The public just was not in the mood to cast a lot of blame," says Karlyn H. Bowman, an American Enterprise Institute demographer. "They are not convinced Democrats have a better [economic] approach." In fact, says GOP pollster Whit Ayres: "Most saw the economy heading south before the Republicans took office. They also blamed poor economic conditions on [the September 11] terrorist activity."

Great news for Bush's reelection hopes, right? Not necessarily. While the President's party, helped enormously by opposition ineptitude, weathered a small downdraft, Bush can hardly afford to relax about the economy in the future. Indeed, there are at least two scenarios that could give the President a bad case of economic heartburn—and give his political advisers nightmares.

Scenario One—a second recession triggered by an external shock—is con-

sidered the most plausible because it could be a byproduct of Administration plans to attack Iraq next year. In that event, consumer spending and business investment could be put on hold for months unless it becomes clear that the American intervention is shaping up as a quick, decisive encounter.

What if the attack sows regional instability and sends oil prices skyward? "Oil shocks caused the last three recessions," notes Princeton University economist Alan S. Blinder. "In a U.S. economy that's teetering, that would cause another recession." Adds GOP lobbyist Edward W. Gillespie, a Bush strategist: "If we get a double-dip, all bets are off in terms of the 2004 election."

Scenario Two, admittedly a long shot, posits something scarier than a second slump: a lengthy, Japan-style economic funk. The cause: war jitters, lingering effects of overcapacity in tech and telecom, CEOs' desire to squeeze profit gains in a disinflationary environment out of worker productivity rather than new investment, and slowly rising unemployment that kicks the props out from under consumer spending and the housing market.

White House economic guru Lawrence B. Lindsey, admittedly a chronic bear, fears that without new fiscal stimulus next year, malaise could become a much more serious threat. But if either Lindsey's or Blinder's worst fears come true, the result is the same. George W. Bush could face a huge reelection challenge, much as his father did, over an economy too weak to be obscured by the fog of war. "I don't think Bush is home free," says Michael Franc, vice-president of government relations at the Heritage Foundation. "If you start hearing about a Bush squeeze on middle-income families, there's a problem."

The fact is, there's a statute of limitations on any President's ability to claim that the economic cards were dealt to him by his predecessor. "If the first two quarters [of 2003] come in weak, this becomes the Bush Economy," says a top GOP strategist. That means even the economically savvy swing voters who have given George W. a giant pass in Election '02 will have a new judgment to render—and another chance to consider whether Bushonomics is as investor-friendly as its adherents claim.

With Lorraine Woellert, Laura Cohn, and Howard Gleckman in Washington

THE DEMOCRATS' DEEPENING DILEMMA

As a disappointing Election '02 winds down with nary a hanging chad in sight, Democrats have few obvious villains to blame for their fall fade-out. Instead, party factions are girding for a familiar ritual: the morning-after round of back-biting and recriminations.

Some of the loudest complaints emanate from the party's left, where advocates of unapologetic government activism believe the main reason Democratic candidates failed to fire up core voters on Nov. 5 was the party's embrace of warmed-over Bushism. Their prescription: a damn-the-deficit stimulus plan that commits a flood of federal dollars to fighting economic stagnation—most targeted at the working class.

Naturally, moderate New Democrats see things differently. For starters, they're uncomfortable with class-based appeals. And they worry that Senate Democratic Leader Tom Daschle's ties to Big Labor pushed him to obstruct too many Bush initiatives, a stance that backfired with swing voters. Finally, centrists think the party's mixed message on fiscal restraint weakened what could have been an effective economic assault on George W. Bush's Republicans.

Call it the Agenda Gap. By failing to develop a pro-growth alternative to Bushonomics, Dems were forced to fall back on shop-worn vows "to preserve and protect" Social Security and Medicare from real and

DASCHLE:
Donkeywork ahead

imaginary attack. "Democrats are now hard-wired to just talk about Social Security and Medicare," says Will Marshall, president of the Progressive Policy Institute, a moderate think tank. Many of the party's New Dems agree. "Any ad you saw from us this year could have been run 10 years ago," sighs Democratic consultant Kenneth Baer. "Bill Clinton provided a vision for how government could work, and so did George Bush. What Democrats pushed in 2002 was intellectually tired."

As this internal left vs. right debate rages, about the only thing all can agree on is that both the Democrats' message and messengers in 2002 were woefully ineffective. Democrats "weren't on target with any message," concludes Costco Wholesale Corp. CEO James D. Sinegal, a party supporter. "I think it's a reflection of the lack of leadership in the Democratic Party."

That's a key reason Democratic centrists want to look past Washington entirely, hoping to find leadership among such newly elected moderate governors as Michigan's Jennifer M. Granholm and Penn-

sylvania's Ed Rendell. "The most important thing Democrats can do is break the grip of Washington and the congressional wing," says Al From, founder of the centrist Democratic Leadership Council.

In reality, not even the most sizzling freshman governor can step up to counter Presidential stardust. In all likelihood, that means the party's internal tensions will remain unresolved until 2004, when it nominates a standard-bearer to challenge Bush. "We're wandering around in a woozy period just like the one Republicans encountered after Ronald Reagan," says Democratic consultant Joe Trippi. "There's no one around to fill Bill Clinton's big shoes."

That's not to say that the election aftermath won't prompt a bevy of Clinton wannabes to try. House Minority Leader Dick Gephardt of Missouri is relinquishing his leadership post to free up time for an expected run at the Presidency, attempting a Clinton-

style fusion campaign that blends business tax breaks with an assertive foreign policy. Al Gore, who campaigned hard for his party in Florida's gubernatorial race and elsewhere, will accelerate the pace of his "major policy addresses," a move meant to signal his imminent Presidential bid. Elsewhere, a crop of candidates ranging from centrist North Carolina Senator John Edwards to Massachusetts Senator John F. Kerry, a harsh Bush war critic, are blitzing New Hampshire and Iowa trying to fire up the faithful.

All that's missing, some glum Democratic insiders lament, is a Clinton-style policy synthesizer and a Clinton-style communicator, and a...well, you get the idea.

By Lee Walczak, with Alexandra Starr and Howard Gleckman, in Washington

For '04, they'll have to bridge the gap between liberals and New Democrats

The Great Divide

WORKING-CLASS HEROES Liberals want to drop the Clinton-era focus on balanced budgets and stress major fiscal stimulus. Key elements: tax cuts for lower-income Americans, killing off Bush's rate cuts for the well-to-do, and a massive slug of spending for safety-net programs. Deficit? What deficit?

NEW DEMOCRATS Moderates believe that without a commitment to spending restraint, swing voters will desert the party. They favor stimulative tax breaks for business investment, especially for the hard-hit tech sector. Rather than end the Bush tax cuts, they'd try to give them a more progressive cast in future years.



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COMMENTARY

By Mike McNamee and Paula Dwyer

WHAT THE NEXT SEC CHIEF NEEDS: A PASSION FOR REFORM

When George W. Bush took office in 2001, Wall Street waited anxiously for the President to name a new Securities & Exchange Commission chairman. It took months. The job simply wasn't that important to the new Administration. Now the helm of the SEC is unmanned again. But this time, Bush doesn't have the luxury of delay. Investor confidence in financial markets in the two years leading up to Bush's own reelection bid depends in no small part on the President's pick to run this small, no-longer-obscure agency.

Still smarting from corporate scandals and huge stock losses, investors aren't likely to return in force to the markets unless the SEC and Congress keep the reform momentum rolling. The next SEC chief must bring to the job a passionate desire to rid Wall Street of its conflicts

and to force business to clean up its accounting and financial engineering.

That's not the view within the Administration, which largely believes that a few bad executives are spoiling the reputation of the whole country club. Emboldened by its election sweep, the White House could figure all it needs is a tough cop at the SEC. It could make a splash by recruiting former Wall Street prosecutor and New York Mayor Rudolph W. Giuliani, but he's thought not to want the job. Other enforcers dominate the list of likely candidates: Assistant Attorney General Michael Chertoff, who's playing a key role in the Justice Dept.'s corporate-crimes task force, or Mary L. Schapiro, head of National Association of Securities Dealers' regulatory arm.

Enforcement is fine. Yet Bush also

needs a true reformer. And he should pay careful attention following the self-immolation of Harvey L. Pitt, who resigned as SEC chief on Nov. 5 after committing one gaffe too many. Pitt's problem wasn't that he was a weak cop: He spurred the SEC's Enforcement Div. to come down harder than ever on executives from WorldCom Inc., Enron Corp., and the like. No, what undid Pitt was the sense



UP IN SMOKE Pitt's last gaffe was bungling the appointment of Webster, who may step aside, too

that he would take only minimum steps to bring change to corrupt, conflicted systems.

The next SEC chairman has a lot of damage to undo. The Bush Administration has waffled on providing the SEC with the staff and pay levels it needs. No one should take the job without demanding that the White House sign off on the full \$750 million in SEC funding that Congress has proposed. Morale at the agency suffered badly under Pitt, so the next chairman ideally would be an SEC veteran who can quickly restore the agency's *esprit de corps*. Pitt also weakened

the SEC's relations with Capitol Hill, even as he needlessly politicized the agency. "The next SEC chairman needs to be a peacemaker because Pitt got the commission voting on party lines," says Paul B. W. Miller, accounting professor at the University of Colorado at Colorado Springs.

So who meets the necessary criteria? Bush's onetime lawyer, James R. Doty, a former SEC general counsel, certainly does. Former federal judge and SEC enforcement chief Stanley Sporkin would bring even more gravitas to the job. But the best test should be whether a new SEC chief is determined to outlaw practices that favor financial interests over investors. Wall Street is desperate for a strong hand at the SEC to rein in New York State Attorney General

Eliot Spitzer. Yet Spitzer wouldn't have become such a powerful force had Pitt's SEC not downplayed the Street's conflicts. The next SEC boss must make true changes—especially in the IPO process—to cure those conflicts.

And let's not forget the accountants. Pitt's choice to head a new accounting oversight board, William H. Webster, is likely to step aside. The remaining four commissioners should appoint John H. Biggs, until recently CEO of pension-fund giant TIAA-CREF. It was Pitt's rejection of Biggs after the accountants objected to him that greased the skids under the SEC chief. Without Biggs, or someone

like him, investors will think the SEC isn't serious about audit reform.

No one in business likes regulation, and any reforms must be balanced. But investors are still awaiting proof that the seamy underside of the markets, so vividly exposed over the last year, has really been cleaned up. Wall Street, the business community and, ultimately, the Bush Administration will all be better off with an SEC chief who realizes that the job of reform has just begun.

McNamee and Dwyer cover the SEC.



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SOFTWARE

WHAT'S A RIVAL TO DO NOW?

Getting out of Microsoft's way becomes a key survival skill

By the time the antitrust case against Microsoft Corp. ended with a whimper on Nov. 1, the guys who started it all had long since given up the fight. Marc Andreessen, whose Netscape Communications Corp. was trounced by Microsoft in the Internet browser wars, steers well clear of his former nemesis. Indeed, for his startup, Opsware Inc., he purposely chose a business that Microsoft isn't yet chasing—server-automation software. “Everybody should compete with Microsoft once in their lifetime,” says Andreessen, “so they have stories to tell their grandchildren. And then don't do it anymore.”

It's hard to fault Andreessen for feeling that way. During the half-decade that Microsoft has been under intense government scrutiny, the Redmond, Wash., behemoth has become more powerful than ever. Now, unconstrained by the court's slap-on-the-wrist settlement, Microsoft is free to spend its \$40 billion cash hoard to enter new markets or ac-

quire companies practically at will. Anybody who was counting on the Feds to rein in Microsoft is flat out of luck. Their only remaining hope is that an antitrust probe by the European Union could take it down a peg.

So how are tech rivals and customers adjusting to the prospect of living with an unfettered Microsoft? For many companies, survival means figuring out when to accommodate the giant and when to fight. For corporate customers, it's about making sure they have viable alternatives to Microsoft products.

In the wake of the court verdict, Microsoft says it's going to be a good citizen. “We're committed to moving forward as a responsible leader in an industry that is constantly, constantly changing,” says CEO Steven A. Ballmer. But Ballmer also has said there's no business that he will rule out entering. Analysts expect the company to plow into new corporate-software markets and perhaps even to greatly expand its technology-consulting services—com-

peting with the likes of Accenture Ltd and Electronic Data Systems Corp.

Already, Microsoft is attacking new worlds. Among them are “smart” mobile phones for Web surfing and run-the-business applications for small and midsize companies. In each case, the company will leverage its monopoly products, Windows and Office, to get a leg up on the competition. In the business-application market, Microsoft is building links between its accounting programs—which have lots of competition—and its Office word-processing and spreadsheet programs—which don't.

When Microsoft eyes the competition these days, it sees a ragtag band, not an army. AOL is still No.1 in online services, with a 31% U.S. market share vs. 10% for Microsoft's MSN. But a steep advertising decline has AOL on the defensive. Sun Microsystems Inc.'s one-third revenue drop over the past two years curbs its ability to stay ahead of Microsoft in high-end computer software. Meanwhile, Apple's share of the U.S. PC market fell from 4.5% to 3.9% in the third quarter, says Gartner Dataquest. In their weakened state, these foes can't put up a fierce fight when Microsoft plows into new markets.

COMMENTARY

By Mike France

UNCLE SAM'S TRUSTBUSTERS: OUTGUNNED—AND OUTMODED

The Microsoft case was about more than just the software giant's misbehavior. Antitrust law itself was also on trial—and it has clearly been weakened by the outcome.

From its inception, this case was supposed to prove that trustbusting is still relevant in the Digital Age. When the Justice Dept. sued the company in 1998, it argued that the century-old Sherman Antitrust Act could be applied swiftly and predictably to police high-tech monopolies. These claims now look pretty dubious.

That's bad news for Microsoft's rivals. But the shortcomings of antitrust are likely to have broader repercussions. As the digital economy evolves, it is likely to be full of natural monopolies in hardware, software, and communications, since consumers have reason to prefer unified tech standards. The Microsoft case offers little



hope that the Sherman Act will be a useful tool for regulating such emerging monopolies. “This is the first of many similar issues that are going to arise,” says Walter W. Hu, a senior fellow at the Manhattan Institute. The problem of monopolies “at the center of regulatory debate years to come.”

One of the main assertions of the New Antitrust to establish widely accepted rules on how high-tech monopolies were supposed to behave. But this hasn't h



Microsoft's Growing Appetite

Market Shares

New PC Operating Systems

1997	2001
86%	93%

New Server Operating Systems

1997	2001
24%	49%

Browsers

1999	2002 EST.
67%	96%

Handheld Operating Systems

1999	2002 EST.
14.4%	24.4%

Data: IDC, WebSideStory's StatMarket

John A. McKinley Jr., executive vice-president and head of technology for Merrill Lynch & Co.

To hold their own against Microsoft, rivals will have to be more nimble—and just as aggressive. Intuit Inc. beat Microsoft in the tax business by creating both a software product and a successful online tax service before the Redmond giant entered as a software-only player. While other pioneers eventually succumbed to Microsoft, Intuit stays ahead by targeting just a handful of markets and pricing even more aggressively than Microsoft does. “We didn’t count on a silver bullet from Washington,” says Intuit founder Scott D.

Cook. “We believe you win the old-fashioned way—in the market.”

The same could be said for rivals in the world of mobile gizmos. Microsoft has had its eye on wireless phones for years, but mobile-phone giant Nokia Corp. is fighting back with relentless innovation and a willingness to take risks. Nokia surprised the world last

The juggernaut's No. 1 counterbalance is not a company but a technology: the free Linux operating system. It's catching on for server computers with a market share of 26%, up from 6% five years ago. Now, thanks to a clumsy move by Microsoft itself, Linux adoption could quicken. Microsoft's new licensing rules, which went

into effect on Aug. 1, raised prices for at least 20% of its corporate customers. That prompted 7% to look for alternatives, according to a survey by Goldman, Sachs & Co. For corporations, choosing Linux is about protecting themselves from too much dependency on Microsoft. “Riding that [Linux] wave will give us choices going forward,” says

—in part because there isn't any isan consensus about the dangers monopoly power. And despite all the power devoted to the matter, the could not resolve the main issue: type of software can be bundled the operating system? This ques- will continue to dog the tech indus- Microsoft leverages its Windows monopoly in an effort to gain ground in ts for application software, hand- devices, and Web services. Tinted, the matter of bundling is no problem to solve. Yet the best le- nds in the country failed to come h even a useful intellectual work for analyzing the issue. “If ng, the law is more confusing t used to be,” says Stephen D. a, a Manhattan litigator who was ad lawyer for the states in the hase of the antitrust trial. t's particularly troubling because,

as this case amply demonstrated, anti-trust law remains much more subject to political interpretation than other fields of law. And politics are going to remain a big part of trustbusting because cases still take so long. Despite the use of imaginative procedural shortcuts, the

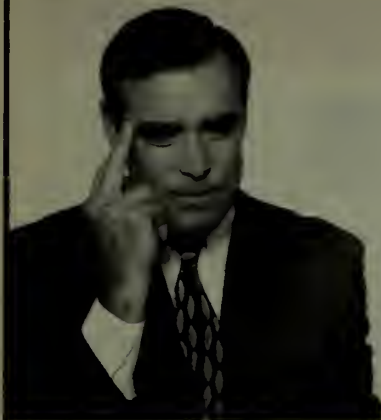
Equally disturbing is the apparent inability of antitrust law to come up with effective solutions to anticompetitive behavior. Although Microsoft's foes supplied strong arguments justifying the application of the settlement to prevent anticompetitive behavior in new markets,

The Microsoft verdict bodes ill for the future. Tech startups bullied by a giant will wait a long time—or in vain—for the cavalry to show up

Microsoft suit has dragged on for more than four years. The result suggests that any big antitrust defendant in the future will be able to count on stretching its cases through at least one Presidential election—and, with any luck, finding a sympathetic Administration.

U.S. District Judge Colleen Kollar-Kotelly was wary of doing so. But should trustbusters punish only misbehavior that is five years old? If so, the Sherman Act of 1890 is not meeting the challenge of a rapidly evolving high-tech future.

With Dan Carney in Washington



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fall by offering to license its crown-jewel handset software for phones that offer Web browsing and messaging. Today more than a million new Nokia-powered phones have been shipped. Meanwhile Microsoft has virtually zero share. And its showcase client, British phone maker Sendo Holdings PLC, is switching to Nokia's software.

While many venture capitalists won't invest in companies that compete with Microsoft, a few do so—judiciously. “We

By being both nimble and aggressive, Nokia and Intuit have fended off forays by Microsoft

will still invest in areas competitive with Microsoft if we believe we can build a business to effectively compete with them. In areas such as telecom they are only now building expertise,” says Gary E. Rieschel, partner at Mobius Venture Capital.

Ignoring Microsoft won't work. Tech companies understand that it'll jump into any software business where the opportunities are large. So the smart ones try to ensure at least a level field. That's how IBM approached the just-emerging market for so-called Web services. IBM forged a sometimes uneasy partnership with Microsoft to develop standards to give the nascent industry a boost. Now that standards are in place that don't favor any one company, IBM believes it can outdistance Microsoft.

Still, most tech companies aren't capable of standing up against the software giant, so their best bet is to avoid a pitched battle. SONICBlue Inc., the purveyor of ReplayTV personal video-recorder service, is aiming for the high end of the market where Microsoft doesn't yet play. “We're going to be the small guy in the field for a long time and in situations where they're coming up against us, we're going to have to scramble to get out of the way,” says CEO L. Gregory Ballard.

The drawback with that tactic? In most everybody does it, eventually there will be few alternatives, and we'll be seeing Windows just about everywhere for a long time to come.

By Steve Hamm in New York, with Jay Greene in Seattle, Andy Reinhardt in Paris, and bureau reports



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EDITED BY MONICA ROMAN

ONE CINGULAR SENSATION?

CINGULAR WIRELESS, THE NO. 2 cell-phone operator, named Stan Sigman president and CEO on Nov. 6. A veteran of SBC Communications, which co-owns Cingular along with Bell South, Sigman built SBC Wireless into a regional power with about 11 million subscribers, in part through acquisitions. As COO of SBC, he was instrumental in improving the once-shabby network's service quality in the Midwest. Now, as the wireless industry copes with sluggish growth, investors are pressing operators to turn a profit. Sigman's strong operations background makes him well-equipped for such demands.

THE FOG LIFTS FOR UNITED

UNITED HAS BOUGHT SOME TIME in its struggle to fend off bankruptcy. On Nov. 5, the

parent of United Airlines said it had reached a deal with German bank Kreditanstalt to roll over \$500 million in debt due on Nov. 17 and Dec. 2. Furthermore, Lufthansa, a marketing partner with United, says it might help UAL with a loan or an investment. UAL has said it doesn't have the cash to pay its debt and will have to file Chapter 11 unless it gets \$1.8 billion in government-guaranteed loans. UAL isn't in the clear yet: It still must win wage cuts from unions to secure the government-backed loans.

WORLDCOM: THE ROT KEEPS SPREADING

THE LARGEST CASE OF ACCOUNTING fraud in U.S. history keeps growing. WorldCom admitted on Nov. 5 that it may have misreported profits since 1999 by as much as \$9 billion—\$2 billion more than it admitted earlier this year. The higher figure was reported as part of the Securities & Exchange Commission's amended complaint against the telecommunications giant, which is now trying to reorganize in bankruptcy court. Such disclosures are likely to further spook the company's customers and creditors. Confidence has also been shaken by revelations that government investigators are trying to determine whether WorldCom founder Bernard Ebbers illegally used some of the \$415 million he borrowed from the company for his personal use.

NOW, FASB MAY GET TOUGH ON OPTIONS

THE DECADE-LONG WAR OVER whether to reduce corporate earnings for the cost of issuing stock options is heating up again. The Financial Accounting Standards Board will review the issue early next year, FASB Chairman Robert Herz told a confer-

HEADLINER: JEFFREY BARBAKOW

THE AUDITOR IS IN

The storm engulfing Tenet Healthcare CEO Jeffrey Barbakow is growing nastier. On Nov. 6, the Santa Barbara (Calif.) hospital operator disclosed that the U.S. Health & Human Services Dept. is launching an audit of its billing for Medicare outlier payments—reimbursements for treatments that cost more than standard procedures. The audit is a response to a UBS Warburg report questioning how Tenet's outlier payments could have tripled in three years when the industry average has declined.



week after the FBI said it was investigating whether two doctors performed unnecessary heart procedures, some of them billed to Medicare, at a Tenet hospital. Barbakow is no stranger to scandal: When he took over nine years ago, he overhauled ethics policies at Tenet, then facing allegations of billing fraud. He says the company is cooperating with authorities and launching its own internal probe. Still, Tenet's stock has dropped 43%, to \$26.80, since the concerns came to light on Oct. 28.

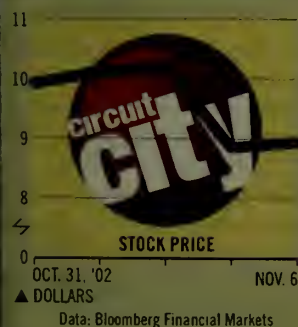
The news came just one

Arlene Weintraub

CLOSING BELL

SHORT CIRCUIT

Circuit City Stores shares fell 13% on Nov. 5, to \$8.85, after warning earnings would drop. The retailer had expected a small profit in its third quarter ending Nov. 30 but now projects a loss due to slowing sales of high-margin items such as digital satellite systems. Consumer jitters may also mean a weak Christmas.



ence of corporate financial executives on Nov. 4. FASB backed down nearly a decade ago from requiring expensing, after leading members of Congress responded to heavy industry lobbying by threatening to gut FASB's rulemaking authority. The board will reconsider its stance now that the International Accounting Standards Board in London has decided to make expensing options one of its requirements. FASB and IASB have pledged to work together to fashion consistent global accounting practices.

ISN'T IT FUNNY, HOW AN HEIR LIKES MONEY?

WINNIE-THE-POOH IS TURNING into one hot honey pot. The Bear, Piglet, and Eeyore produce an estimated \$1 billion a year in video, DVD, and other sales for Walt Disney. On Nov. 6, Disney asked a court effectively to invalidate

a 72-year-old pact that gives U.S. rights to the heirs of Stephen Slesinger, a literary agent who bought the rights from Pooh author A.A. Milne in 1930. Slesinger's widow and daughter have been fighting Disney since 1991, claiming that their royalties haven't been fully paid. Disney wants a U.S. court in Los Angeles to validate a new agreement that it says it signed with Milne's granddaughter, who Disney claims can "recapture" the rights and sign a new agreement with the media company.

ET CETERA...

- Cisco Systems had quarterly earnings of \$618 million, vs. a year-ago loss of \$268 million.
- Enron ex-CFO Andrew Fastow pleaded not guilty to financial wrongdoing.
- State Street will buy Deutsche Bank's global custody business for \$1.5 billion.



JAPAN

QUICK STUDIES

Here's how a few Japanese blue chips are shaping up

Just 18 months ago, Shiseido Co., Japan's largest cosmetic group, looked like it needed a major makeover. Like many Japanese businesses, Shiseido had sought to dominate its market by blitzing customers with scores of product lines. The trouble was that Shiseido execs had little notion of what was selling. The company had warehouses full of unsold cosmetics, yet couldn't meet demand for some of its hottest items. The inefficiencies hurt: Over the past two years, Shiseido has lost more than \$550 million.

Realizing they were in trouble, company execs last year swung into action. They cut costs, streamlined product lines, and—most important—improved inventory control. After installing a new

computer network linking factories, sales staff, and 16,000 stores, Shiseido managers can now more accurately forecast demand. They have slashed inventory by a third from a year ago, helping land Shiseido back in the black. On Nov. 6, the company reported net profits of \$81 million for the six months ended Sept. 30, compared with a \$12 million loss a year ago. "We're showing other Japanese companies that it's possible to reverse a slide," boasts Seiji Nishimori, Shiseido's chief logistics officer.

Shiseido is one of a handful of Japanese blue chips that are honing survival skills to avoid sinking in the quagmire of Japan's decade-long economic swamp. In the process, these companies are getting more efficient and profitable—and

are better able to compete in the global marketplace. Many are investing in new technologies to wring excesses out of operations and manufacturing. They're spinning off noncore operations to focus on their specialties. And all are improving cash flow and stressing research and development. The model: Toyota Motor Corp., Japan's most profitable company. "Toyota concentrates on generating long-term cash flow to invest in R&D," says Keio University economics professor Masaru Kaneko.

Granted, for every Japanese success story there are dozens of "zombies." Every time such companies approach insolvency, they're kept afloat with new cash from banks—at the behest of a government fearful of unemployment

SLEEKER Shiseido streamlined product lines

"90% of the Japanese economy is made up of domestic companies that are low-tech and low-productivity," points out Masao Hirano, director of Japan operations at consultancy McKinsey & Co. By following the leaders, he says, the zombies "will change, too, but only gradually and with a lot of pain."

Japan's economic woes could still drag down even the successful companies. Most of them depend on foreign markets for the bulk of their sales. A swoon in U.S. consumer spending would dash the recovery of vulnerable high-tech businesses such as NEC Corp. and Toshiba Corp. Other concerns are a stronger yen, which would hurt profits, and rising energy costs in the event of war in Iraq. And the Japanese economy, now emerging from its fourth recession in a decade, could easily get sucked back into the quicksand.

No one is more confident of clearing all the hurdles than Fujio Mitarai. He's chief executive of Canon Inc., the world's leading maker of copiers and laser printers. Few Japanese corporate bosses have done more in recent years to cut costs, shore up earnings, and improve cash flow. To boost efficiency, Mitarai scrapped assembly lines in all of Canon's 29 Japanese factories, replacing them with small squads of about a half-dozen employees who can do the work of 30 people under the old system. The shift enabled the company to reduce inventories of parts by more than 30% and close 20 of its 34 warehouses. Better, Canon increased earnings by 53%, to \$471 million, in the most recent quarter. "Manufacturing is where most of the costs lie," Mitarai says. "We're much more profitable today because of these changes."

Corporate Japan can also take lessons from Sharp Corp. A pioneer in liquid crystal displays, Sharp has seen its once-dominant position challenged by Taiwanese and Korean rivals. So in recent years, company execs have ceded the low-margin market for PC monitors, concentrating instead on high-end displays for cell phones, handheld computers, and digital cameras. That's an area where Sharp maintains a technological edge due to its expertise with low-energy devices. And it is now building a

and social chaos if they fail. Despite Japan's reputation for just-in-time supply management,

\$1 billion factory for large LCD panels which, it claims, will triple its productivity. "Sharp is ahead today because it's focusing on its core competence and investing in R&D," says Kun Soo Lee, industry analyst with WestLB Securities Pacific Ltd.

There's even hope for Japan's high-tech Goliaths. After a decades-long obsession with increasing sales and market share while ignoring profitability, industrial-electronics groups such as Toshiba, Hitachi, and Fujitsu are struggling to downsize and reduce excess capacity. They should follow NEC's lead. The company was the first to spin off its money-losing memory-chip business and shutter aging plants. And it merged its profitable unit making chips for cars and the electronics industry into a new company, which will be better able to respond rapidly to semiconductor-industry fluctuations. The plan will let NEC

GETTING THE IDEA

In the face of Japan's decade-long economic funk, some companies have learned survival skills

CANON

Shifted production from assembly lines to small teams of workers who build entire products, cutting inventories by 30%

CURRENT PROFITS*

\$471

(millions)

YEAR-AGO PROFITS

\$307

(millions)

NEC

Spun off money-losing chip operations and closed factories to focus on mobile phones, software, and broadband

CURRENT PROFITS*

\$8.5

YEAR-AGO PROFITS

-\$245

SHARP

Focusing on high-end screens for cell phones and digital cameras, while boosting research spending to stay ahead of rivals

CURRENT PROFITS*

\$188

YEAR-AGO PROFITS

\$134

SHISEIDO

Cosmetics maker networked factories, retailers, and sales force to reduce inventory by one-third

CURRENT PROFITS*

\$81

YEAR-AGO PROFITS

-\$12

*Most recent reporting period, either quarter or half-year, ended in September

Data: BusinessWeek, company reports

concentrate on more profitable endeavors, such as developing new cell phones and building computer systems for corporate clients. "We were proud of our great technology, and [we] just pumped out products without thinking of our customers' needs," admits board member Kaoru Tosaka. "Now, we're emphasizing efficiency, profits, and clients."

Sony Corp., too, is getting a face-lift. Its consumer-electronics products are quickly becoming low-margin commodities that China can churn out for a fraction of the cost. So Sony is investing heavily in R&D to develop a new type of microchip to power not only its PlayStation video game console but a range of electronic devices such as wireless hand-



held computers. The chip will be far speedier than current processors and offer more realistic graphics and superfast game-playing over networks. It "will be a technology driver for our next-generation products and services," says Ken Kutaragi, president of Sony Computer Entertainment.

These are tough economic times, especially in Japan. But recession and global competition are creating some success stories, even as much of Japan falls farther behind. These leaders show that "by becoming better focused, [Japanese companies] can survive and even prosper," says Satoru Oyama, senior analyst with Lehman Brothers Japan Inc. The rest of Japan Inc. would do well to pay heed.

By Irene M. Kunii in Tokyo

WINNER?
Sharp's PDA
with a camera

COMMENTARY

By Mark L. Clifford and Pete Engardio

IS THE SUN SETTING ON HONG KONG'S FREEDOM?

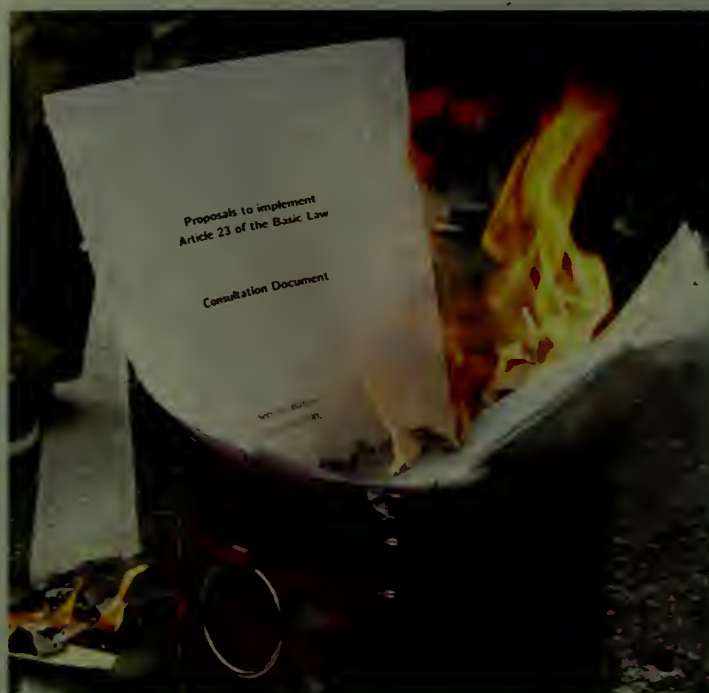
After Hong Kong released its proposal for tougher national-security laws on Sept. 23, only a dozen people showed up at a protest rally. That complacency now is giving way to a firestorm of criticism. As they digest the details, political activists and business, media, and legal professional associations are sounding alarms.

What a relief. The controversy has revived the feisty, freedom-loving Hong Kong that seemed to be disappearing amid the recession and absorption into China. If only Hong Kong can use this flap to retrieve its freedoms, all of Asia could benefit.

The debate is emerging as a defining moment for Hong Kong and its future as one of Asia's most open societies. It is a crucial test for the Beijing-backed Administration of Chief Executive Tung Chee-hwa. If Tung and Beijing are wise, they will listen to the criticism and tone down the worst aspects of the legislation, which could crimp Hong Kong's value as an international business center. If corporations and foreign governments with stakes in Hong Kong are wise, they will start complaining as well, both privately and publicly.

At issue is how Hong Kong lives up to Article 23 of the Basic Law, which China and Britain negotiated in the 1980s in view of the 1997 handover. It states that Hong Kong must prohibit "treason, secession, sedition, subversion against [China], or theft of state secrets." The Basic Law doesn't define these offenses; it simply says Hong Kong must enact the needed legislation "on its own."

Hong Kong could have taken a minimalist approach by modifying its existing laws, leaving civil liberties intact. Instead, the Tung government consulted Beijing and concocted chilling measures that Democratic Party



DRACONIAN Proposed curbs on free speech and political action are harsher than on the mainland

BURNING NATIONAL-SECURITY DRAFT LAWS

Chairman Martin Lee calls "the last nail in the coffin" of political freedoms. Hong Kong probably won't make public its draft of the legislation until January. But measures in the consultation paper would make it a criminal offense to obtain or publish "unauthorized and damaging disclosure of protected information." The new law would let authorities ban activities whenever they believe that doing so is "in the interests of national security or public safety or public order."

Critics fear Hong Kong's controls on speech and political activity will be like China's. In fact, says Yuen Ying Chan, head of the University of Hong Kong journalism department, the proposed laws "are more restrictive than on the mainland." Journalists in China, for example, have been jailed for publishing "state secrets" as banal as unreleased economic data. In Hong Kong, they could be

prosecuted merely for "unauthorized possession" of information.

Foreign business organizations are concerned. "The free flow of information is one of the major attractions for business here," says American Chamber of Commerce Chairman James E. Thompson. AmCham is likely to call for a full debate on the draft bill itself.

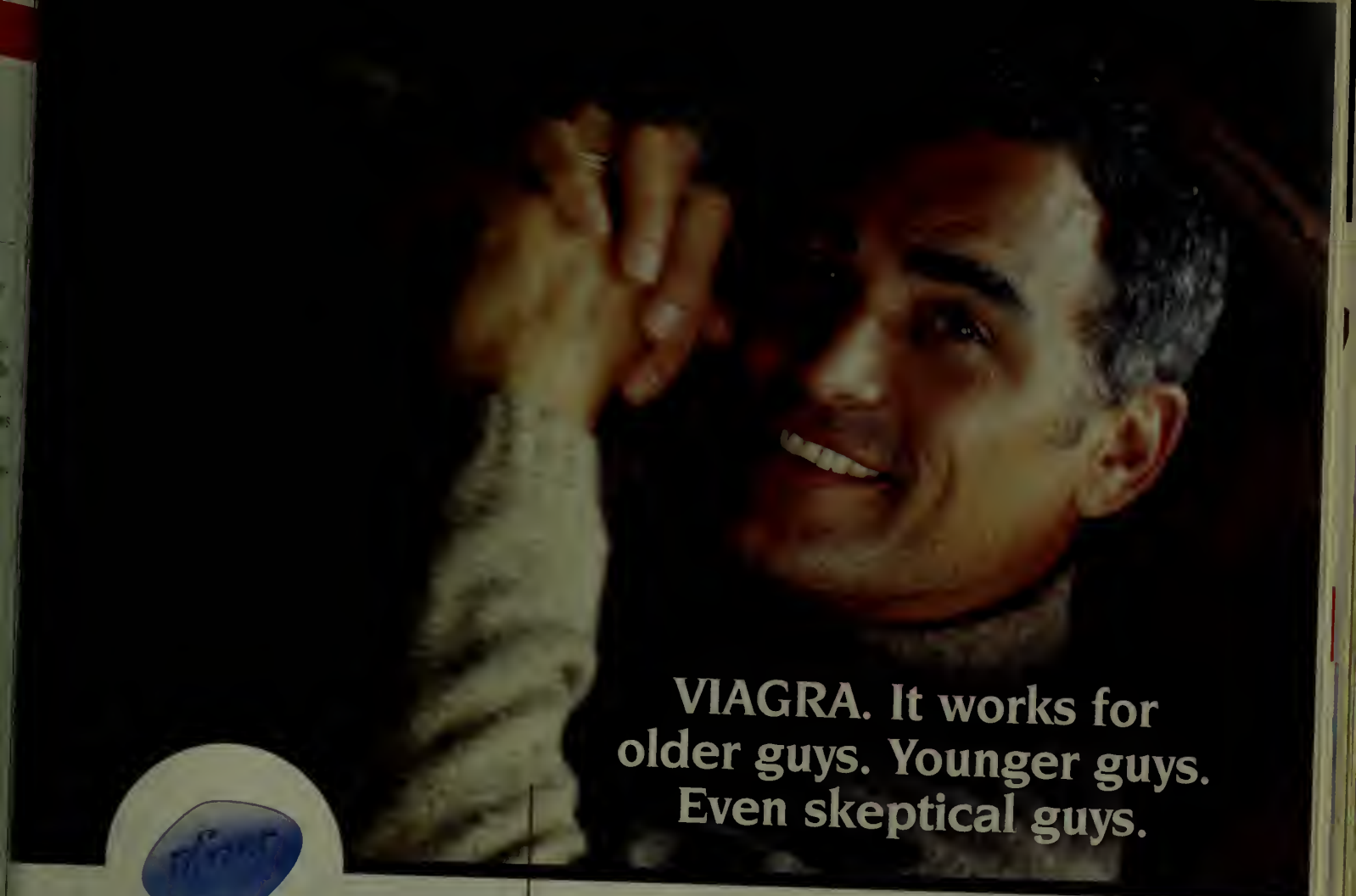
There are signs Hong Kong's leaders are becoming less deaf to complaints. Officials say the Article 23 bill presented to the legislature, probably in January, may be more lenient than the consultation paper.

"The key issue is whether we're prepared to listen to objections and amend our proposals," says Security Secretary Regina Ip. Officials also assure that the worst fears are unwarranted. "Clamping down on press freedom is the last thing we want," says Solicitor-General Robert Allcock. "These will be Hong

Kong rules administered by Hong Kong courts."

Well-intentioned public servants come and go. Rule of law means putting justice in the hands of statutes and courts, not the discretion of whoever is in power. What Hong Kong needs is clear laws that meet international norms for freedom of information and association—but comply with Article 23. It is not too late for Tung's government as well as Beijing to back off from some of the most draconian ideas. Besides, five years after the handover, Hong Kong remains remarkably stable despite a feisty press and opposition parties. Leaders in both Hong Kong and Beijing must realize an open society is one guarantee of the city's continued prosperity.

Clifford manages the Hong Kong bureau. Engardio is a senior news editor in New York.



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VIAGRA is indicated for the treatment of erectile dysfunction. Remember that no medicine is for everyone. If you use nitrate drugs, often used to control chest pain (also known as angina), don't take VIAGRA. This combination could cause your blood pressure to drop to an unsafe or life-threatening level.

Discuss your general health status with your doctor to ensure that you are healthy enough to engage in sexual activity. If you experience chest pain, nausea, or any other discomforts during sex or an erection that lasts longer than 4 hours, seek immediate medical help. The most common side effects of VIAGRA are headache, facial flushing, and upset stomach. Less commonly bluish vision, blurred vision, or sensitivity to light may briefly occur.

Please see patient summary of information for VIAGRA (25-mg, 50-mg, 100-mg) tablets on the following page



PATIENT SUMMARY OF INFORMATION ABOUT

VIAGRA
 (sildenafil citrate) tablets

This summary contains important information about **VIAGRA**. It is not meant to take the place of your doctor's instructions. Read this information carefully before you start taking VIAGRA. Ask your doctor or pharmacist if you do not understand any of this information or if you want to know more about VIAGRA.

This medicine can help many men when it is used as prescribed by their doctors. However, VIAGRA is not for everyone. It is intended for use only by men who have a condition called erectile dysfunction.

VIAGRA must never be used by men who are taking medicines that contain nitrates of any kind, at any time. This includes nitroglycerin. If you take VIAGRA with any nitrate medicine your blood pressure could suddenly drop to an unsafe or life threatening level.

What Is VIAGRA?

VIAGRA is a pill used to treat erectile dysfunction (impotence) in men. It can help many men who have erectile dysfunction get and keep an erection when they become sexually excited (stimulated). You will not get an erection just by taking this medicine. VIAGRA helps a man with erectile dysfunction get an erection only when he is sexually excited.

How Sex Affects the Body

When a man is sexually excited, the penis rapidly fills with more blood than usual. The penis then expands and hardens. This is called an erection. After the man is done having sex, this extra blood flows out of the penis back into the body. The erection goes away. If an erection lasts for a long time (more than 6 hours), it can permanently damage your penis. You should call a doctor immediately if you ever have a prolonged erection that lasts more than 4 hours.

Some conditions and medicines interfere with this natural erection process. The penis cannot fill with enough blood. The man cannot have an erection. This is called erectile dysfunction if it becomes a frequent problem.

During sex, your heart works harder. Therefore sexual activity may not be advisable for people who have heart problems. Before you start any treatment for erectile dysfunction, ask your doctor if your heart is healthy enough to handle the extra strain of having sex. If you have chest pains, dizziness or nausea during sex, stop having sex and immediately tell your doctor you have had this problem.

How VIAGRA Works

VIAGRA enables many men with erectile dysfunction to respond to sexual stimulation. When a man is sexually excited, VIAGRA helps the penis fill with enough blood to cause an erection. After sex is over, the erection goes away.

VIAGRA Is Not for Everyone

As noted above (*How Sex Affects the Body*), ask your doctor if your heart is healthy enough for sexual activity.

If you take any medicines that contain nitrates—either regularly or as needed—you should never take VIAGRA. If you take VIAGRA with any nitrate medicine or recreational drug containing nitrates, your blood pressure could suddenly drop to an unsafe level. You could get dizzy, faint, or even have a heart attack or stroke. Nitrates are found in many prescription medicines that are used to treat angina (chest pain due to heart disease) such as:

- nitroglycerin (sprays, ointments, skin patches or pastes, and tablets that are swallowed or dissolved in the mouth)
- isosorbide mononitrate and isosorbide dinitrate (tablets that are swallowed, chewed, or dissolved in the mouth)

Nitrates are also found in recreational drugs such as amyl nitrate or nitrite ("poppers"). If you are not sure if any of your medicines contain nitrates, or if you do not understand what nitrates are, ask your doctor or pharmacist.

VIAGRA is only for patients with erectile dysfunction. VIAGRA is not for newborns, children, or women. Do not let anyone else take your VIAGRA. VIAGRA must be used only under a doctor's supervision.

What VIAGRA Does Not Do

- VIAGRA does not cure erectile dysfunction. It is a treatment for erectile dysfunction.
- VIAGRA does not protect you or your partner from getting sexually transmitted diseases, including HIV—the virus that causes AIDS.
- VIAGRA is not a hormone or an aphrodisiac.

What To Tell Your Doctor Before You Begin VIAGRA

Only your doctor can decide if VIAGRA is right for you. VIAGRA can cause mild, temporary lowering of your blood pressure. You will need to have a thorough medical exam to diagnose your erectile dysfunction and to find out if you can safely take VIAGRA alone or with your other medicines. Your doctor should determine if your heart is healthy enough to handle the extra strain of having sex.

Be sure to tell your doctor if you:

- have ever had any heart problems (e.g., angina, chest pain, heart failure, irregular heart beats, or heart attack)
- have ever had a stroke
- have low or high blood pressure

- have a rare inherited eye disease called retinitis pigmentosa
- have ever had any kidney problems
- have ever had any liver problems
- have ever had any blood problems, including sickle cell anemia or leukemia
- are allergic to sildenafil or any of the other ingredients of VIAGRA tablets
- have a deformed penis, Peyronie's disease, or ever had an erection that lasted more than 4 hours
- have stomach ulcers or any types of bleeding problems
- are taking any other medicines

VIAGRA and Other Medicines

Some medicines can change the way VIAGRA works. Tell your doctor about **any medicines** you are taking. Do not start or stop taking any medicines before checking with your doctor or pharmacist. This includes prescription and nonprescription medicines or remedies. Remember, VIAGRA should never be used with medicines that contain nitrates (see *VIAGRA Is Not for Everyone*). If you are taking a protease inhibitor, your dose may be adjusted (please see *Finding the Right Dose for You*). VIAGRA should not be used with any other medical treatments that cause erections. These treatments include pills, medicines that are injected or inserted into the penis, implants or vacuum pumps.

Finding the Right Dose for You

VIAGRA comes in different doses (25 mg, 50 mg and 100 mg). If you do not get the results you expect, talk with your doctor. You and your doctor can determine the dose that works best for you.

- Do not take more VIAGRA than your doctor prescribes.
- If you think you need a larger dose of VIAGRA, check with your doctor.
- VIAGRA should not be taken more than once a day.

If you are older than age 65, or have serious liver or kidney problems, your doctor may start you at the lowest dose (25 mg) of VIAGRA. If you are taking protease inhibitors, such as for the treatment of HIV, your doctor may recommend a 25 mg dose and may limit you to a maximum single dose of 25 mg of VIAGRA in a 48 hour period.

How To Take VIAGRA

Take VIAGRA about one hour before you plan to have sex. Beginning in about 30 minutes and for up to 4 hours, VIAGRA can help you get an erection if you are sexually excited. If you take VIAGRA after a high-fat meal (such as a cheeseburger and french fries), the medicine may take a little longer to start working. VIAGRA can help you get an erection when you are sexually excited. You will not get an erection just by taking the pill.

Possible Side Effects

Like all medicines, VIAGRA can cause some side effects. These effects are usually mild to moderate and usually don't last longer than a few hours. Some of these side effects are more likely to occur with higher doses. The most common side effects of VIAGRA are headache, flushing of the face, and upset stomach. Less common side effects that may occur are temporary changes in color vision (such as trouble telling the difference between blue and green objects or having a blue color tinge to them), eyes being more sensitive to light, or blurred vision.

In rare instances, men have reported an erection that lasts many hours. You should call a doctor immediately if you ever have an erection that lasts more than 4 hours. If not treated right away, permanent damage to your penis could occur (see *How Sex Affects the Body*).

Heart attack, stroke, irregular heart beats, and death have been reported rarely in men taking VIAGRA. Most, but not all, of these men had heart problems before taking this medicine. It is not possible to determine whether these events were directly related to VIAGRA. VIAGRA may cause other side effects besides those listed on this sheet. If you want more information or develop any side effects or symptoms you are concerned about, call your doctor.

Accidental Overdose

In case of accidental overdose, call your doctor right away.

Storing VIAGRA

Keep VIAGRA out of the reach of children. Keep VIAGRA in its original container. Store at room temperature, 59°-86°F (15°-30°C).

For More Information on VIAGRA

VIAGRA is a prescription medicine used to treat erectile dysfunction. Only your doctor can decide if it is right for you. This sheet is only a summary. If you have any questions or want more information about VIAGRA, talk with your doctor or pharmacist, visit www.viagra.com, or call 1-888-4VIAGRA.

23-5515-00-4
June 1999

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Printed in USA/September 2001



PACKING TOMATOES: Some Mexican crops are strong sellers in the U.S.

MEXICO

FARMERS ARE GETTING PLOWED UNDER

With tariffs disappearing, U.S. exports to Mexico may soar

It was quite a parade. Farmers in Mexico recently marched hundreds of squealing pigs through La Piedad, a small town in Guanajuato state. The show of porcine heft was a protest against an expected avalanche of U.S. bacon, ham, and pork chops when import tariffs on a variety of farm products are eliminated next year under the North American Free Trade Agreement. Some U.S. pork cuts already cost just 27¢ a pound in Mexico, vs. \$1.14 for domestic pork, and import prices will likely drop further. "If our situation doesn't change quickly, Mexico's 15,000 pork producers face complete collapse," says Carlos Ramayo, head of the Confederation of Mexican Pork Producers.

Mexico and the U.S. are headed for a major food fight. Starting on Jan. 1, Mexico must scrap tariffs on a dozen key products, including rice, potatoes, pork, and chicken, that have enjoyed special protection under NAFTA. To Mexicans, agriculture's importance is not measured in dollars—in fact, the sector contributes 4% of gross domestic product. But 10 million people, about one-quarter of the Mexican workforce, still live off the land. And the dirt-poor

campesino remains a potent symbol of Mexico's revolutionary legacy.

No wonder this latest round of tariff cuts is fast turning into a hot-button issue in Mexican politics. What especially galls the Mexicans is that they have to fight with one hand tied behind their backs. According to Mexico's National Agricultural Council (CNA), the average Mexican farmer receives just \$722 in annual subsidies, while U.S. farmers stand to collect \$20,800 a year as part of a \$180 billion farm bill approved earlier this year. Mexican President Vicente Fox in October warned fellow rancher George W. Bush that the U.S. subsidies could push up unemployment in Mexico's countryside and drive farmers across the border. "Many farms are going to disappear," warns CNA President Armando Paredes, who figures at least 750,000 jobs could go next year alone.

American farmers point out that Mexico's agricultural exports to the U.S.

have nearly doubled, to \$6.3 billion, over the past decade. "It's been a win-win situation for both countries as far as increasing exports goes," says Terry Francel, a senior economist at the American Farm Bureau Federation. Mexico has fared particularly well with labor-intensive crops: Today, more than half the cucumbers and over one-third of all tomatoes eaten in the U.S. are grown south of the border. But U.S. producers, with their large, capital-intensive farms, superior technology and infrastructure, have boosted their exports of rice, cattle, dairy products, and apples by more than 15% a year since NAFTA took effect. Mexico's agro deficit with the U.S. reached \$4.1 billion last year.

Mexico has been reluctant to tarnish its free-trade credentials by resorting to nontariff barriers such as anti-dumping duties, and sanitary restrictions—means by which U.S. tomato and avocado farmers have kept Mexican products out of some markets. But the gloves are expected to come off as the country heads for midterm elections in July, 2003. This month, Fox is due to announce a raft of new measures to "armor-plate" the agricultural sector from increased competition. Expect more anti-dumping measures, such as the 46.6% duty officials imposed on U.S. shipments of Golden and Red Delicious apples starting in August. "We will not hesitate to utilize all of the protective mechanisms established by national and international legislation," Fox told a gathering of Mexican farmers in early November.

But no matter what Fox does, the countryside will suffer from the new onslaught. Mexican farms average just 13 acres, a legacy of a land reform introduced after the Mexican Revolution. Farmers also pay 40% more for diesel fuel and face sharply higher interest rates on loans. "If Mexico's farm sector is to survive, the government is going to have to give out more subsidies," says Juan Habermann, a prosperous grower of green beans and sorghum in the state of Sinaloa. Fox might be happy to oblige. But there's little room in the tight federal budget for such largesse. For Mexican farmers, bringing home the bacon keeps getting harder.

By Geri Smith in Mexico City

DOWN ON THE FARM IN MEXICO



The new Hungary

A computer in every classroom,
a tech cluster in every city, and
a minister to watch over them all



...scientists have traditionally been one of Hungary's prime exports.

You won't find it reported in any statistics, but scientists have traditionally been one of Hungary's prime exports—as a glance at the long list of Hungarians heading and staffing world-renowned research institutes and hot high-techs reveals.

A number of the scientists returned to Hungary after a few years in the west to work for the institutes or companies clustering in and around the universities providing them with their world-class training. The largest of these clusters are found in Budapest.

The nodes of the southern Budapest cluster are Budapest's Technical University and the Infopark. Now in its fourth year, this office complex-cum-incubation center is home to research, production and administration facilities set up by Hewlett Packard, Panasonic, AT&T and many other tech heavyweights.

With their ranks including Microsoft and others, these heavyweights have accounted for a large part of the above-mentioned exports, sending Hungarian scientists abroad for a few weeks or months of advanced training.

Microsoft's operations, in turn, are located in Graphisoft Technology Park. Graphisoft is indisputably Hungary's most successful high-tech company. Its "ArchiCAD" software has become one of the world's leading tools of building design.

Graphisoft founded its park in 1998. Located in northern Budapest, the Park keeps on expanding. The Park's ninth building has just been completed,

reports the company. Similar clusters have been or are now being set up in Hungary's eleven other university towns.

Ramping up and reaching out

This nationwide exercise in cluster-building is the final link in the chain of IT skills-building furthered by Hungary's government upon taking office in May, 2002.

The initial link involves the wiring of Hungary's primary school classrooms, of which 50% are already outfitted with a PC and a teacher capable of instructing his or her charges in its use. Already one of the highest percentages in the world, this percentage is to be increased to 100% over the next few years.

Hungary's high school classrooms have already achieved that mark. These classrooms are now being successively linked into the SULINET. This Intranet is a repository of technical information and teaching programs. The third link in the chain: the achieving of IT skills has become mandatory for all students attending Hungary's 18 universities and polytechnics.

Presiding over this exercise in skills-building is Kálmán Kovács, who was chosen to head the newly-created ministry of information and communication.

It was an eminently logical decision. Also a professor of computer sciences at Budapest's Technical University, Kovács formulated and proposed "Towards a knowledge-based society." This piece of legislation is widely credited with having triggered Hungary's development into a high-tech contender.

Thirteen years of progress

- 1989** End of Communist rule in Hungary, triggering return to democracy and free market economy
- 1991** Hungary enters into a "Europe agreement," making the country an associate member of the EU
- 1996** Hungary joins OECD
- 1998** Negotiations begin on Hungary's acceding to the EU
- 1999** Hungary joins NATO
- 2002** Coalition headed by Péter Medgyessy wins national elections
- 2004** Hungary accedes to the European Union (projected)

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ON HUNGARY

A bigger EU, a bigger NATO—and bigger roles for Hungary Interview with László Kovács

László Kovács,
Minister of
Foreign Affairs

During his first stint (1994 to 1998) as Hungary's foreign minister, László Kovács put Hungary on a fast-track to membership in NATO and in the EU. Under his stewardship, Hungary also took a highly active role in achieving prosperity in Central Europe and peace in the Balkans.

Kovács' second stint is being spent furthering these processes, and in facilitating Hungary's transition to a "new normalcy."

Question: On October 9, the European Commission issued its long-awaited, decisively-important enlargement report. How did Hungary fare?

Kovács: The report finalized the road map for Hungary's acceding to the EU by 2004. The report also gave high marks to our accession efforts. We were pleased, but not surprised, at the report. Its conclusions and the findings underpinning them reiterated those of its predecessors: that Hungary has, over the past twelve years, forged a strong democracy, one marked by the rule of law, respecting human rights and the freedom to pursue individual development.

All this should not be construed to mean that the long and arduous work of transforming our country is over, that we can cruise to accession. Far from it. As the report detailed, we have to continue to wage the good, long-term fight against corruption and against discrimination, and for the creation of institutions capable of facilitating the development of our individual regions and agricultural sector.

Among the accession candidates receiving positive appraisals from the Commission are two of our neighbors—Slovenia and Slovakia. And that, in turn, is very good news for Hungary. It would not be in our interests to have a new dividing line running through Central Europe.

The report was good news for us, for Central Europe as a whole—and for the continent of which we have returned to being an integral part. This process of pan-European reunification will be greatly furthered by the next wave of accession. By ensuring the continent-wide sharing of the benefits of peace and prosperity, accession will create a stronger Europe.

Question: Over the last eleven years, Hungary has been, thanks to the "Europe Agreement," an associate member of the Union. Your country's economy is, for all intents and purposes, part of that of the Union. The question arises: what practical benefits will Hungary reap from accession?

Kovács: The Hungarian government will have the opportunity to participate in decision-making processes, and thus have a say in the formulation of the rules subsequently applied to us. Our citizens will get the right to study, live and work wherever they want in the Union.

And Hungary itself will get the benefit of being a full and formal part of one of the world's great success stories.

This story is of nations coming together to forge a community of shared values and objectives, ones impelling joint actions. These, in turn, have brought prosperity to all the member countries.

Question: NATO recently announced plans to admit a further seven Central and Eastern European countries. Will this influx give Hungary a new role in NATO, as a mentor for its neighbors?

Kovács: I would not call it a new role. Over the last three years, we staunchly supported NATO's eastward expansion, knowing that it would enhance the security and stability of Europe as a whole, and knowing that it would provide further impetus to the transformation processes taking place within the potential members.

During this period, we have also systematically shared with these countries the experiences which we gathered during the process of accession and in the subsequent period, so as to speed and ease the preparation process. Rather than mentoring, I would prefer to call this outreach a "proactive partnership." It will of course be set forth in the years to come.

Written by Terry Swartzberg
Designed by dotCOMMS.net

Some of the ministers
of the present
Hungarian government:

Péter Medgyessy,
Prime Minister

László Kovács,

Minister of Foreign Affairs

Csaba László,

Minister of Finance

István Csillag,

Minister of Economy

and Transport

Kálmán Kovács,

Minister of Informatics

and Communications

Mária Kóródi,

Minister of Environment

and Water Management

Imre Németh,

Minister of Agriculture

and Regional

Development

Péter Bárándy,

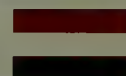
Minister of Justice

Ferenc Juhász,

Minister of Defense

Hungary

The Republic of Hungary



Area: 93,000 square kilometers **Population:** 10.25 million

Capital: Budapest (1.93 million)

Other major cities: Debrecen (210,000), Miskolc (182,000), Szeged (169,000), Pécs (163,000), Győr (131,000)

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MEDICINE

A DIRECT HIT TO PARKINSON'S?

Infusing GDNF shows promise for brain-cell regeneration

For the victims of brain diseases, the golden hope is that scientists will figure out how to make damaged cells deep inside the brain regenerate. If this magic capability could be extended to the frayed neurons of patients suffering from Alzheimer's, stroke, Lou Gehrig's disease, or Parkinson's, their brains might restore themselves, much like skin that heals after a cut.

For Parkinson's sufferers, this dream may be moving toward reality thanks to the revival of a drug written off as a failure just three years ago. A clinical trial at the University of Kentucky is currently treating 10 Parkinson's patients with a bioengineered protein, called GDNF, using a radical new drug-delivery method that sends it deep into the part of the brain where Parkinson's originates. There, a constant supply is administered by a pump implanted in the chest. So far, GDNF seems both to shield healthy brain cells from the disease and cause damaged cells to regenerate.

After just a few months of testing, says Kentucky investigator Greg Gerhardt, there is evidence of improvement in patients. In addition, British doctors reported last April that a similar trial in Bristol, England, improved muscle control of all five

patients tested within a month of treatment.

These results, while preliminary, were welcome news for Amgen Inc., the world's biggest biotech player and the only maker of GDNF. In the late 1990s, Amgen injected the protein into the brains of a number of Parkinson's patients. The drug showed no positive effect, and in 1999, Amgen managers dropped it from their development program. Doctors now believe the trial failed because GDNF never reached the

region of the brain affected by Parkinson's. Amgen's enthusiasm cooled, but academic researchers at several institutions were convinced that GDNF held promise and kept working on their own. The University of Kentucky team, along with British neurosurgeon Dr. Stephen Gill, who led the Bristol study, figured out the new delivery method used in the current tests. Several other research centers are drawing up plans for similar trials.

The Kentucky scientists received a \$5 million grant from the National Institute of Neurological Disorders & Stroke (NINDS), a division of the National Institutes of Health, to fund their trial. They also persuaded Amgen to collaborate. Today, Amgen CEO Kevin W. Sharer calls GDNF "one of the most promising products" in the company's pipeline, and Amgen is planning clinical trials of its own. Sharer cautions that GDNF is still in a very early testing phase: "We don't want to give false hope, but if this proves to be a success, it will be a wonderful advance."

Even a modest advance would be

SENDING TREATMENT TO THE SOURCE

SUBSTANTIA NIGRA



OVERHEAD VIEW OF BRAIN

The Experiment

The brain protein GDNF, which is believed to restore damaged neurons and protect undamaged ones, is stored in a pump implanted in the patient's chest. The drug is pumped through a catheter running under the skin, up through the neck, and into the substantia nigra. In one very small trial, symptoms improved within a month of direct infusions of the drug.

The Disease Parkinson's occurs when cells in the substantia nigra, deep inside the brain, die. These cells emit the chemical dopamine, which is needed for muscle control. With progressively less of it, Parkinson's victims develop violent tremors and loss of balance.





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fantastic. Parkinson's is a progressive disease of unknown cause that affects as many as 1.2 million people in North America. The illness destroys the cells in a portion of the brain called the substantia nigra that is responsible for the production of dopamine, a chemical involved in muscle control. As the level of dopamine gradually drops, the disease's characteristic tremors start. These grow violent as the illness progresses and are accompanied by stiff limbs, frozen facial muscles, and eventually, rigid immobility. While generally not fatal, Parkinson's is gruesomely debilitating. Most victims are over 50 when the disease strikes, but about 10% are under 40; actor Michael J. Fox first experienced tremors when he was 29. There is no cure, only treatments to alleviate symptoms, which lose effectiveness over time and can have severe side effects.

Scientists have hoped that GDNF might provide relief ever since its function was discovered in 1993. GDNF stands for glial cell line-derived neurotrophic factor, a protein produced by the connective tissue, or glial cells, between the neurons of the central nervous system. Animal studies indicated early on that

GDNF can not only halt but reverse the damage caused by Parkinson's. But GDNF is a large molecule that cannot be absorbed through the stomach or penetrate the protective blood/brain barrier, ruling out pills and shots. That seemed to leave only one option: delivering it directly to the brain, a risky venture in human patients.

In early Amgen trials, doctors injected GDNF into the lateral ventricle, a fluid-filled portion of the outer brain. The theory was that the fluid would carry the drug deep into the brain. Instead, says Gerhardt, director of the University of Kentucky's Parkinson's research center, GDNF stuck to the walls of the ventricle. Gerhardt and Donald M. Gash, who runs the university's magnetic-resonance-imaging center, spent five years

trying to come up with a better way.

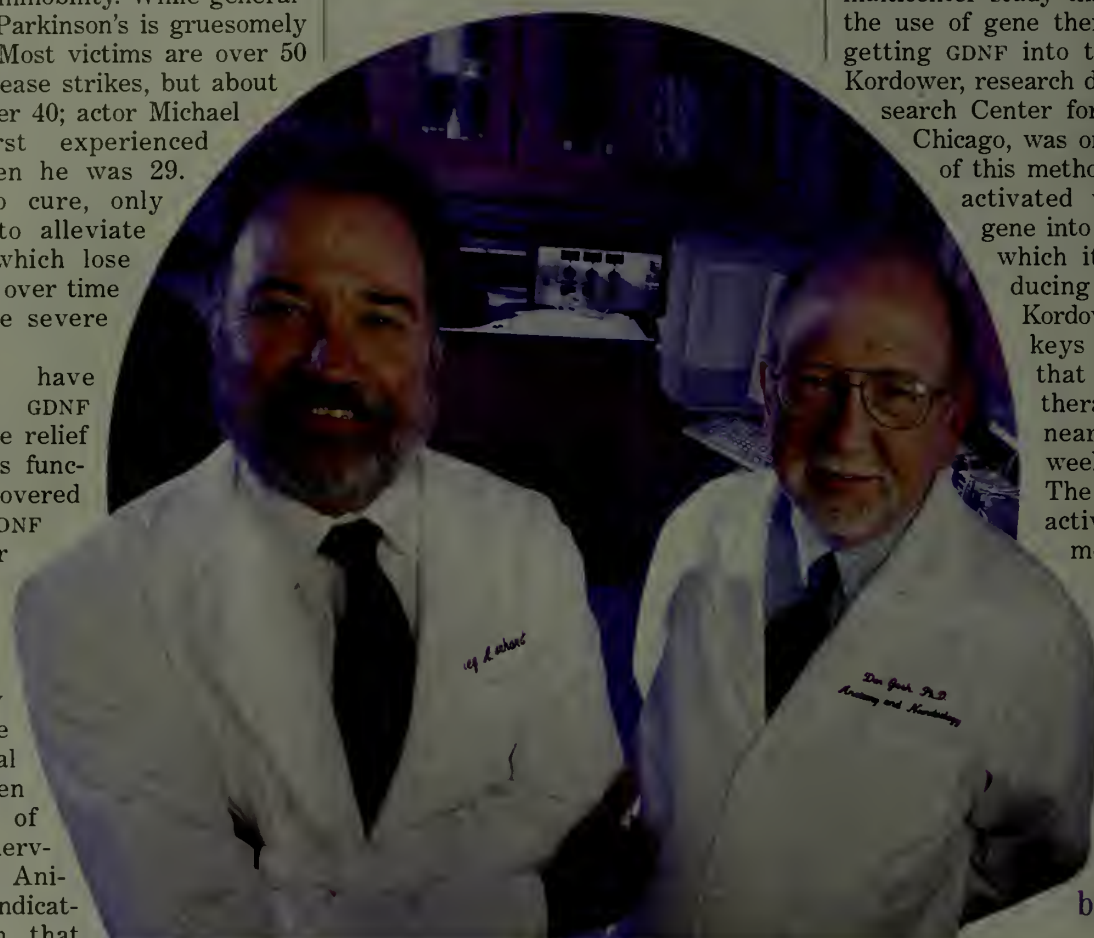
The result is a complicated delivery system built around a Medtronic Inc. implantable pump called the SynchroMed, in use since 1988 to administer chemotherapy and painkillers. For the Parkinson's trial, a small catheter is threaded into the substantia nigra using MRI coordinates to precisely map the route. The catheter is attached to a tube that runs under the skin, down the neck, to a SynchroMed implanted in the chest. About three inches in diameter,

directly into the brain" is effective in restoring dopamine function.

Still, many drugs over the years have proved effective in animals only to fail in humans. "GDNF is really promising," says Diane D. Murphy, program director of the neurodegeneration group at NINDS. But she is not convinced that infusion is the best approach. "You need constant, ongoing infusions, and that's a problem," she says. "We need a less invasive delivery method."

To that end, NINDS is funding a large, multicenter study that will investigate the use of gene therapy as a way of getting GDNF into the brain. Jeffrey Kordower, research director at the Research Center for Brain Repair in Chicago, was one of the pioneers of this method. He uses an inactivated virus to carry a gene into cells of the brain, which it prods into producing more GDNF. In Kordower's studies, monkeys with Parkinson's that underwent gene therapy performed at near-normal levels a week after treatment. The genes remained active up to eight months after injection, and again,

DOGGED It took Gerhardt and Gash five years to find a way to get the drug deep inside the brain



the pump contains four weeks' worth of the drug and is programmed to maintain a constant flow to the brain. It is refilled each month through a port attached to the pump.

Gerhardt says it's too early to draw conclusions since the first human patient began treatment only in May. However, in the October issue of the medical journal *Brain*, Gerhardt and Gash report that rhesus monkeys with Parkinson's showed a significant reduction in symptoms within three weeks of treatment—without any detectable side effects. Autopsies revealed a partial restoration of the dopamine-producing cells, indicating that brain cells could be prodded to repair themselves. An accompanying editorial called this "the first demonstration that GDNF infused

dopamine-producing cells were restored.

Researchers are also trying to develop stem cells that would turn into GDNF-producing cells when placed in the brain. But both gene therapy and stem cells present serious safety issues—recent human trials of both methods in other diseases have produced disastrous side effects. Consequently, human trials are still years away. For now, the direct-infusion method is the most promising. If it works, says Gerhardt, the same procedure could potentially be adapted to treat a variety of brain diseases. Now that scientists understand that brain cells can regenerate, there may finally be a glimmer of hope in treating the horrible ailments that destroy them.

By Catherine Arnst in New York, with Arlene Weintraub in Los Angeles

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COMPUTERS

LOU TAKES THE GLOVES OFF

The IBM CEO on the turnaround—and on his critics

In less than two months, IBM Chairman Louis V. Gerstner Jr. will retire. Outside of the Watsons, no other leader has left as big a mark on IBM. Gerstner has written about his experiences in *Who Says Elephants Can't Dance?* Inside IBM's Historic Turnaround. The book will be in stores on Nov. 12. Recently, a relaxed Gerstner met with

Associate Editor Ira Sager. Gerstner, for the first time, answered critics who have charged that his turnaround was built on fancy financial footwork. He also tackled CEO compensation, discussed what's wrong with the computer industry, and disclosed a surprise about his future plans: He's going to study Chinese history and archaeology.

“I realized the problems weren't strategy. They were: How do I execute that strategy?”

In those first months after you replaced former IBM CEO John F. Akers, what was your biggest surprise?

I went into IBM believing that its problems were primarily strategy and execution. When I got there, I found out that the direction the company needed to go was pretty clear. This was not a question of picking a direction and saying: “Charge!” You would do that and turn around and nobody was following behind you.

It was an organization of fiefdoms. People had the view that “if this is not in my interests, I'm not going to participate.” I felt I had fallen down a rabbit hole. That's when I realized the problems weren't strategy. They were: How do I execute that strategy?

In part, you credit your success to the acquisitions you didn't make. Why?

If life was so easy that you could just go buy success, there would be a lot more successful companies in the world. Successful enterprises are built from the ground up. You can't assemble them with a bunch of acquisitions. [That brings] huge integration problems.

There were few PC companies that we weren't offered at some point. Why would we want to double up in the PC business, ever? Telecommunications companies all over the world proposed joint ventures, affiliations. There were people who suggested we get in the content business. We turned them all down. We made lots of acquisitions, but they [fit] the strategy we already had.

You describe executives in this industry as “remarkably detached from their customers.” What's your beef?

The process of integrating this technology and achieving the benefit is unbelievably painful for companies. The industry has been all about faster, faster, more function, more function. Most devastating from a customer point of view are the lack of standards and the lack of interchangeability. It is truly a mess. You wouldn't deliver steel to General Motors in a different form than every other steel company.

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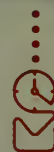
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ucts to customers in this industry consistent with an open-standards-based model of computing. Companies are going to have to learn to compete on that.

Why do you believe Wall Street is too preoccupied with revenue growth as the measure of corporate success?

The value that some analysts put on revenue vs. what they put on profit is out of whack. If you can grow real cash earnings, that's 80% of what you ought to do, and the revenue component is 20%. People overvalued revenue during the time when a lot of companies were generating revenue in unsustainable ways.

Sure, I'd love to have more revenue growth. But I took the position that we were building a new IBM, and it was going to take 5 to 10 years. It was all about a new strategy. It was all about a new culture. I was not going to get distracted because somebody said: "Gee, we'd like to see your revenue a little higher this year."

Critics have questioned the quality of IBM's earnings, suggesting that IBM's turnaround is due to slick financial ploys. Why didn't you use the book to respond?

Those discussions were not relevant to a book that deals with a 10-year history. We've responded in the last year with a lot more disclosure. We've always told people that we made money on intellectual property, and we always gave them the number. But they wanted to see it put in the income statement, so we moved it to the income statement and broke it out. We've always told people in the footnotes what the pension assumptions were, but they wanted it more frequently and more visibly. So we now give them more frequent and more visible discussion. For the most part, the issues for IBM were disclosure. They were never accounting.

A couple of the issues that people have thrown into the bucket of financial engineering I find strange.

Such as?

First, taxes. When I arrived, IBM was paying a huge tax bill every year. Over an eight-year period, we brought the tax rate down. That's as much a responsibility of management as bringing down the cost of information technology, real estate, and anything else. It's an expense of running the business. But for some reason, people think that's financial engineering.

Secondly, share buyback. There is a huge difference between what we hear from our owners and from people in the analyst and media sector. Every single time I have met with owners, they have said to me: "Please don't

to police corporate behavior?

I'm leery of legislative solutions to what is morality. Look at the Sarbanes-Oxley Bill. It sweeps up every company in the world that issues debt or lists a stock on the New York Stock Exchange. It says, you have to have independent audit committees.

You have companies in Europe and Japan that are not organized this way. The concept of independence in some cases flies in the face of the law—for a German company, for example. It has become a trade issue with the EU. Why would the United States want to drive foreign companies out of our capital markets? Our capital markets are a strategic advantage for us from a geopolitical and trade point of view.

How do you protect investors and ensure that corporations follow the rules?

The real mechanism for corporate governance is the active involvement of the owners. We have very large owners in the form of institutional shareholders who could exert substantial influence on what goes on in corporations. But the markets are so liquid here that when they see problems, they sell. If they had to stay in over a period of time because the cost of getting out was prohibitive, then maybe you would see

a little more oversight. One way is to make it far more advantageous for people to be long-term than short-term shareholders.

Your \$127 million compensation package in 2001, along with that of a few other highly paid CEOs, has been criticized as outrageously generous. Do we need a change in CEO compensation?

Compensation needs to be predominantly performance-driven. If CEO compensation was performance-driven, which I believe it was in IBM's case, nobody would ever argue. If the shareholders didn't make billions and billions of dollars, I wouldn't make millions of dollars. My salary was the same for 10



WITH
OUTGOING
CEO JOHN
AKERS IN
1993

“If CEO compensation was performance-driven, which I believe it was in IBM's case, nobody would ever argue”

take the cash and go make stupid acquisitions.”

What we did with cash is, we funded our growth. We never cut back funding research. Next, we gave our employees huge increases in compensation. We pulled down company debt, too.

After we went through that process, we had some cash left. We gave it back to the shareholders in the most efficient way we could, which is not through dividends. It's through share buyback. We did it for 10 years. We always bought, right through thick and thin. If you were talking about financial engineering, then you would buy at certain times and not buy at other times.

What do you think about efforts

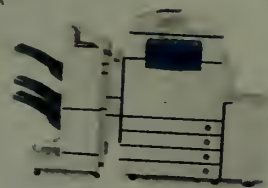
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years. It was all performance-based.

What is the most outrageous is the compensation that has gone to people who have been fired, forced out, whose companies didn't perform well. The American people have no problem paying great athletes and great actors lots of money if they're the best and if they perform well. I hope we're going to see a much tougher set of standards by directors that get compensation tied specifically to corporate performance.

What's next for you?

I'm going to focus a lot on public education reform. I'm in the process of trying to set up a commission on the teaching crisis in America. I have a number of people who have agreed to serve on this commission. I'm trying to raise some money.

Secondly, I'm going to keep my hand in business with a private equity or small venture company. Then I want to go back to school.

School?

I've been accepted at Cambridge University. I want to study Chinese history and archaeology. I want to become a student. I want to read Chinese history and go on a dig. ■

BusinessWeek online

For an expanded Gerstner Q&A, go to the Nov. 18 issue online at www.businessweek.com.

A NO-NONSENSE BOOK—WITH A FEW GAPS

For journalists covering the computer industry, one joy is how readily bigwigs dish the dirt. No other industry, except entertainment, has so many outspoken leaders willing to make outrageous comments—or attack each other publicly. An exception is Louis V. Gerstner Jr. IBM's chairman and former CEO rarely takes to the public stage. As for the media, he believes less is more and seldom grants interviews.

Now, Gerstner has broken his silence in a new book, *Who Says Elephants Can't Dance? Inside IBM's Historic Turnaround* (HarperBusiness, \$27.95). It's a well-written, 372-page account of his 10-year resuscitation of the world's largest computer company. He shares practical experiences, the lessons learned, and even some intriguing observations about Wall Street, corporations, and the computer business.

Yet Gerstner stays true to his nature. There can be little question that he penned the book, since it so clearly reflects his no-nonsense personality. Again and again, he cuts to the chase and avoids chitchat. For example, he promises a brief personal history in one of the early chapters, and he delivers—spending all of six paragraphs on his youth.

Nor should anyone expect a kiss-and-tell book. Gerstner, who likely received an estimated \$4 million advance, which he says he's going to give to charity, comes closest to slinging mud with his description of the computer industry as a "24/7/365 three-ring circus." Even after 10 years in the tech field, he's still amazed how the digerati do business: "If I planned to say even a tenth of what passes for normal business discourse in this industry, my lawyers

would have bound and gagged me and bolted the door."

The broad strokes of Gerstner's story have been well documented, and his account may seem familiar to even the casual reader. On Apr. 1, 1993, Gerstner left RJR Nabisco and "parachuted" into the computer giant, which had racked up \$8 billion in losses and had been forced to slash 73,000 jobs. Scores of consultants were at work preparing to disassemble this icon of American business and spin off the pieces as separate companies.

In comes Gerstner with a different view. He believes Job One is to craft a strategy to keep the ailing giant intact and then to execute. To his surprise, he finds an ossified culture unable to respond to changes in the market—or to his plans. Gerstner says IBM was close to bankruptcy when he arrived, but his delivery is so matter-of-fact, the reader doesn't get a sense of how dire the situation was.

The problems become clearer as Gerstner wrestles with grave cultural issues at Big Blue. For example, he decides he must reduce IBM's country managers' independence. And to get all managers to cooperate, he ties their compensation to overall corporate performance, rather than to the performance of their individual units. This is the book's strongest section, a must-read for any student interested in strategy, corporate behavior, or even simply how to communicate with employees.

The book also includes several Gerstner memos written over the years that provide fly-on-the-wall detail.

But students won't learn much about Gerstner's shortcomings. There is no mention of his failed attempt at the consumer market. His efforts to woo consumers with education software and home networks both sputtered until he unloaded them. He

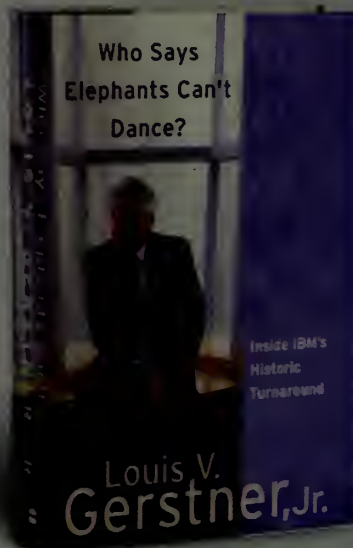
also pulled IBM out of home PCs. Indeed, Gerstner doesn't spend much time on the PC business, a perennial money-loser, or explain why it took him nearly nine years to outsource the production of desktops.

Perhaps the biggest gap in an otherwise solid book is Gerstner's failure to take on his critics. Recently, analysts have asked whether his turnaround wasn't really

the result of fancy maneuvers in the ledger book. While the Securities & Exchange Commission has not found any wrongdoing, critics claim that IBM boosted its share price through share-repurchase programs and that it has not fully disclosed the effect of some asset sales. Gerstner says he didn't think a book describing his past 10 years at IBM was the place for such a discussion.

That's too bad. But in the end, *Who Says Elephants Can't Dance?* still works. Gerstner may not dish the dirt like other tech CEOs, but his rich experience is worth more than any gossip memoir.

By Ira Sager



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STRATEGIES

MATTEL'S NEW TOY STORY



SPONGEBOB: A NICKELODEON DEAL GAVE MATTEL A HIT

Sure, CEO Robert Eckert would love a blockbuster toy. But he won't sacrifice steady growth to get it

Selling toys can be a fickle business, in which the fortunes of the mightiest corporations can abruptly rise or fall on the whims of customers too young to use a credit card, or even cut their own food with a knife. It's a business constantly in search of the next hot thing. Find it, and not only will kids all over the world be happy but so will shareholders. Guess wrong, and you're left with a pile of unsellable knickknacks.

For Robert A. Eckert, CEO of Mattel Inc., that's the wrong way to do business. He believes he can take a lot of the guesswork out by selling toys that make money year in, year out. If he's right, Eckert, 48, and holder of an MBA from Northwestern, will not only steady the notoriously volatile Mattel but maybe even show the industry a better way to operate.

Eckert's mission is to bring the stability

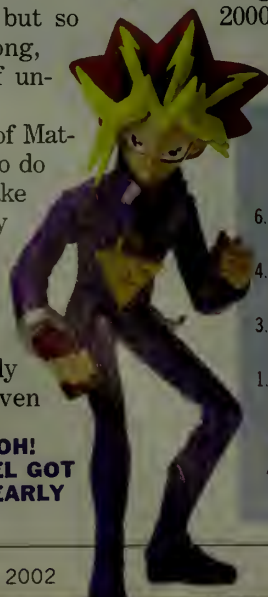
and predictability of a consumer-products company to Mattel, the world's largest toymaker, with nearly \$5 billion in revenues. In his 2½ years on the job, Eckert, the former head of Philip Morris Cos.' Kraft Foods Inc., is already part-way to that goal. He has stopped the hemorrhaging that began under his predecessor, Jill E. Barad, who orchestrated the disastrous \$3.5 billion acquisition of a computer-game outfit, Learning Co. A raft of cost-cutting measures and the divestiture of the money-losing Learning Co. have boosted profits—for now.

Although Mattel lost \$431 million in 2000, net income should hit \$459 million this year, while revenues—reflecting in part

the absence of Learning Co.—will fall to an estimated \$4.7 billion, from \$5.6 billion in 1998, says earnings estimate tracker Muxtex Inc. And Mattel's stock price has doubled from a March, 2000, low of \$9.

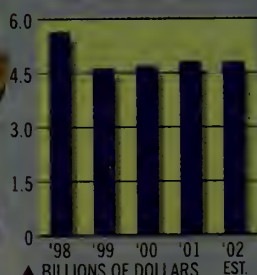
With the easy work done, however, Eckert is hoping that other changes he's implementing will keep Mattel—which still sells a perfectly shaped Barbie somewhere in the world every three seconds—on an even keel. He's striving for less dependence on costly licensed properties, better inventory control, and to develop more toys in-house. He is also looking for strong expansion overseas. Taken together, those initiatives constitute a major change. And they will yield, hopes Eckert, the steady growth an investor could expect at, well, a company like Philip Morris.

The downside of this conservative approach is that Mattel could miss the blockbusters that come along from time to time and cause toy company profits to spike. "This strategy increases the risk that Mattel could underproduce popular toys," says T.K. MacKay, an analyst at research

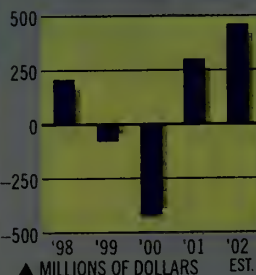


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firm Morningstar Inc. It's a risk Eckert is willing to take.

To see how Eckert's approach—call it hitting singles instead of swinging for the fences—is already paying off, compare the way Mattel handled Harry Potter toys last year with the way its archrival, Hasbro Inc., dealt with Star Wars items. Mattel produced far fewer items than it had made for past big movie tie-ins. That conservative planning paid off when Mattel sold 30% more than it had forecast—\$160 million worth of Potter toys. Warner Bros. Inc., the licensor, was so pleased that it recently signed Mattel to a five-year deal for toys keyed to new movie and TV versions of such favorites as Batman.

Hasbro, by contrast, hitched its star four years ago to a blowout introduction of toys tied to the *Stars Wars* sequels. But licensing fees were costly, sales failed to meet grand expectations, and the company has been struggling with the fallout ever since. Hasbro says it is no longer interested in expensive licensing deals and is now emphasizing its core brands instead.

Eckert is adopting another big tactic of the consumer-goods producers: When a market matures in the U.S., push it overseas. That is why Mattel is coordinating simultaneous product releases worldwide and inscribing packaging with multiple languages. That boosts sales and saves the cost of serial introductions. A big advertising push for Mattel's Hot Wheels brand in Spain, for example, boosted the company's toy-car market share there by 50%. Overall, overseas sales were up 17% in the third quarter. Eckert's goal? Raise international to 50% of Mattel's sales, from 31% today.

True to his consumer-products-company roots, Eckert is also pushing more brand extensions. U.S. sales of Mattel's flagship product, Barbie, fell 6% in the first three quarters—though with \$1.5 billion in annual sales, she is hardly on her last legs. So new Barbies continue to sprout. Indeed, the latest version, Rapunzel Barbie, is seen as the toy likeliest to be a big hit this Christmas, says



TOY SOLDIER
If Eckert brings stability to Mattel, he might just show the industry a better way to operate

PlayDate Inc., a toy marketing outfit.

Mattel is also shipping its toys—which are all made abroad—later in the year to ensure that they're on shelves during the peak holiday sales season. Last year many Holiday Barbies arrived as early as July and eventually had to

be marked down. The recent West Coast port unrest put a crimp in that just-in-time inventory regimen. But Mattel isn't expected to alter the practice long-term.

The company is still looking for the next big thing—if it can find it cheaply. Through long-term contracts, or by spotting a hot property early, the toy-maker can avoid ruinous bidding wars over licenses. Mattel snapped up the rights to *Yu-Gi-Oh!*, a popular Japanese monster-themed TV show before it became a hit, and a long-term licensing pact with Nickelodeon, signed in 2000, means it got first crack at rights to the popular *SpongeBob SquarePants*. Meanwhile, an in-house development group begun by Eckert, Project Platypus, has unfurled its first creation: Ello, a whimsically shaped construction set for girls.

Mattel has managed to nearly fall apart every decade. Founder Ruth Handler was forced out after an accounting scandal in the 1970s. Then came the collapse of the video-game market in the early 1980s, which nearly bankrupted Mattel, followed by the Barad era. Eckert's more measured approach may avoid giant fiascoes, but it still leaves him with a big challenge: figuring out how to wring consistent growth out of the toy market. While he has turned around Mattel, that larger task has just begun.

*By Christopher Palmeri
in Los Angeles*



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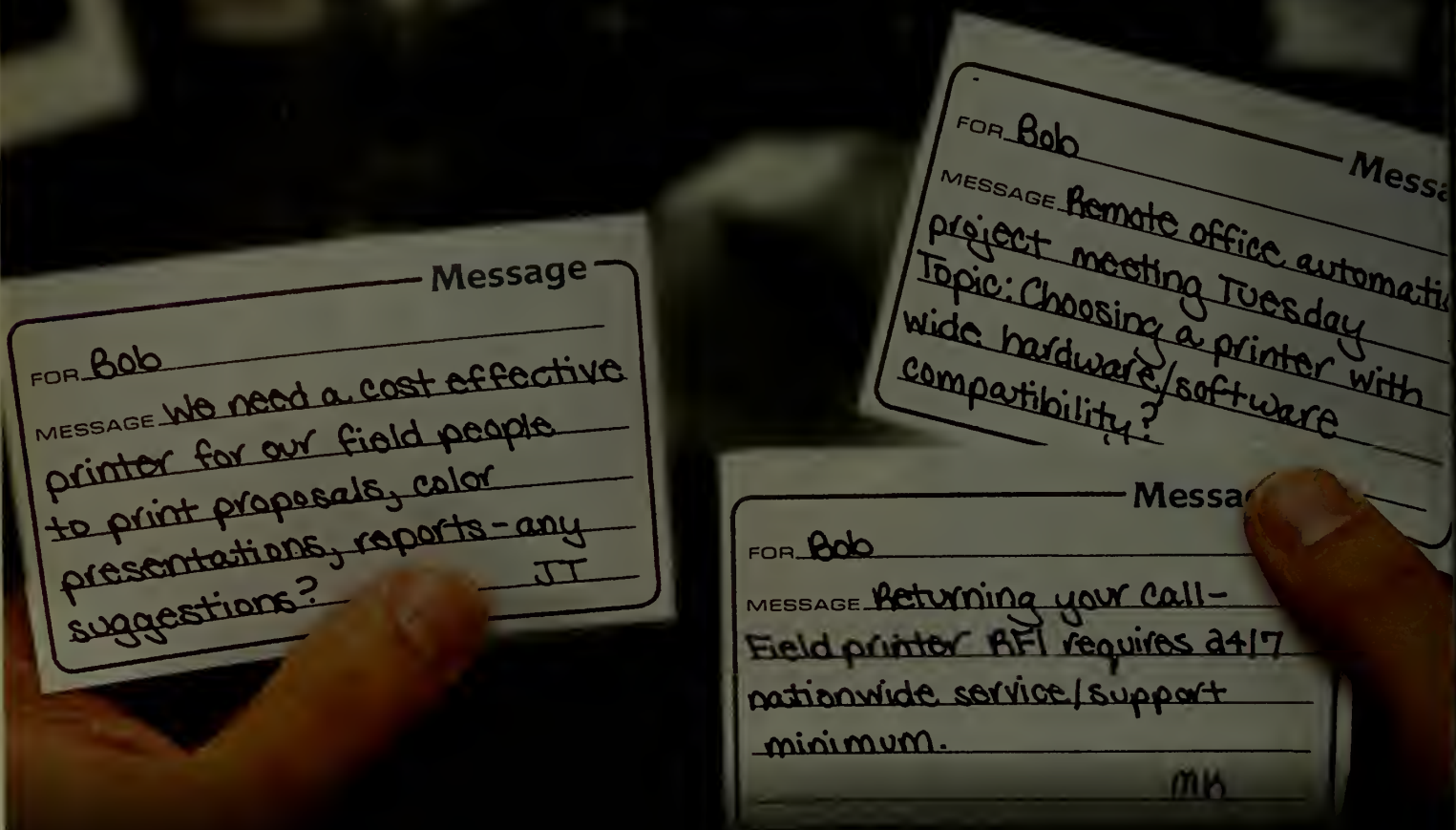
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HIGHWAY CAMERAS THAT CAN DIRECT TRAFFIC

HEAVY TRAFFIC IS MORE THAN just an annoyance for harried commuters. The wasted fuel, lost work hours, and other effects of congested roads cost the 65 largest U.S. cities \$74 billion a year. California alone loses an annual \$20 billion to traffic tangles. So scientists from the University of California at San Diego are developing clusters of networked smart cameras to improve transportation authorities' response to tie-ups and other changing road conditions. If traffic builds up in one spot, for example, the cameras might automatically trigger electronic signs warning commuters heading into the snarl—but still miles away—



ROAD MOVIES: The network could find unclogged routes

to take an alternative route. Unlike the stand-alone cameras used today, the cameras in the experimental UCSD system share information over high-speed links. "They're smarter and faster at interpreting information," says Mohan Trivedi, director of the UCSD Computer Vision & Robotics Research Laboratory. In theory, if a roadside

camera detected an accident, it could send a wireless signal to a robotic camera in the median strip, which would move toward the accident and zoom in to take close-up shots. That could help authorities provide more detailed information about the crash to police and ambulances—and allow doctors to observe victims and provide medical advice to ambulance workers as they're driving to the scene. *Arlene Weintraub*

MULTIPLE SCLEROSIS: A NEW LINE OF ATTACK

DRUGS CALLED STATINS, WHICH lower cholesterol, have already been shown to help stave off heart disease, strokes, and organ rejection after heart transplants. Now, there may be another use for these versatile medicines: treating multiple sclerosis.

In a study reported in the Nov. 7 issue of *Nature*, scientists gave one statin, Lipitor, to mice specially treated to mimic the human form of the debilitating disease. Without the drug, the mice suffered from temporary but recurring paralysis, much the way MS patients do. With the drug, however, the symptoms disappeared. "We were surprised by the magnitude of the effect," says Dr. Scott S. Zamvil, assistant professor of neurology at the University of California at San Francisco. "We basically shut down the disease."

Zamvil and his team were also able to show why the drug works. Multiple sclerosis occurs when the immune system attacks the coating around the body's nerve fibers. In the mice, Lipitor tames this attack by inhibiting the production of inflammation-causing chemicals—and by boosting levels of anti-inflammatory chemicals. Zamvil suggests that the enzyme targeted by the drug to lower cholesterol may also be involved in a different biological pathway—one that controls immune responses.

The next step: carrying out a clinical trial to see whether the statins will work as well in MS patients as they do in the mice. "We don't know yet whether this is going to be an effective treatment, but it is very provocative," says Zamvil. The results also imply that statins could help treat rheumatoid arthritis and other autoimmune diseases. *John Carey*

INNOVATIONS

■ IBM has unveiled the world's swiftest silicon-based transistor, a speedster that switches on and off 350 billion times a second, or 65% faster than the previous record. The design is a bipolar transistor of the type used in systems that process analog signals such as music and voices, and is sculpted from silicon germanium.

■ More bad news on nitrogen pollution from agricultural fertilizers. Researchers at the University of Colorado at Boulder believe excessive nitrogen may trigger the release of carbon trapped in the ground. Soil contains enormous quantities of carbon and naturally disgorges 20 times as much of it each

year as all of industry combined, says a study in the Oct. 31 issue of *Nature*. So even a small increase in soil discharge could vastly boost CO₂ levels.

■ The Office of Naval Research is devising a computer model to provide more accurate storm predictions. Data are coming from a new tower off the coast of Martha's Vineyard that measures temperatures, wind velocity, the speed and direction of water currents, wave height, and so forth. Next summer, more data will be collected from buoys, research ships, and planes monitoring the Atlantic's usual storm paths. The result could be the most elaborate map yet of weather patterns at sea. *Otis Port*



PERFECT STORM? Clocking the wind

PUTTING A GLOSS ON THE RIGHT STUFF

SERENDIPITY IS ALIVE AND well at the Xerox research center in Webster, N.Y. Shen-ge Wang, a principal scientist, and his colleagues were trying to solve the problem of "differential gloss,"

which is responsible for the unwanted plastic-like sheen on high-quality prints and photocopies. "We were trying unsuccessfully to use half-tone designs to suppress the effect," recalls Wang.

Failing that, they decided to make use of it. The result is a new and inexpensive security technology called GlossMarks, which could

someday be applied to protect tickets, personal checks, and other documents from counterfeiters. Using a combination of paper, toner, and special software, Xerox printers can embed any desired image—a picture, fingerprint, or signature, say—onto a glossy paper surface. Tilt the paper, and the embedded image shimmers into view. ■



CAN EARNINGS STAY ON THE RECOVERY TRACK?

Results are up from third quarter last year, a low ebb. But consumer jitters are spreading

Everything, they say, is relative. And that certainly applies to third-quarter corporate earnings. At first glance, results for the 900 companies on *BusinessWeek's* Corporate Scoreboard seem to give investors good reason to pile back into the stock market. Profits were an

astounding 57% higher than a year ago. But look again: Much of the gain is due to big, one-time charges taken last year, so the sharp earnings rebound has more to do with cost-cutting and financial cleanup than with big improvements in core businesses. True, corporate revenues were up a hefty 6%. Yet that's

mostly because sectors like and technology are much stronger than a year ago, when business all but ground to a halt after September 11.

Earnings had only one way to go up. The third quarter of 2001 saw the second-steepest profit drop in the 25-year history of *BusinessWeek's* earnings

Winners and Losers in Quarterly Profits

INDUSTRIES

LEADERS		LAGGARDS	
PERCENTAGE CHANGE FROM 2001's THIRD QUARTER		PERCENTAGE CHANGE FROM 2001's THIRD QUARTER	
METALS & MINING	981%	ELECTRONIC EQUIPMENT	LOSS
TELECOM SERVICES	522	COMMUNICATIONS EQUIP.	LOSS
GAS UTILITIES	178	BIOTECHNOLOGY	LOSS
AEROSPACE & DEFENSE	173	AIRLINES	LOSS
CHEMICALS	148	BUILDING PRODUCTS	LOSS
SOFTWARE	114	WIRELESS TELECOM. SVCS.	LOSS
MACHINERY	99	SEMICONDUCTOR EQUIP.	LOSS
COMPUTERS & PERIPHERALS	93	AUTOMOBILES	LOSS
LEISURE EQUIPMENT & PRDGS.	81	MULTI-UTLS. & UNREG. PDWER	LOSS
TOBACCO	79	INTERNET SOFTWARE & SVCS.	LOSS
SPECIALTY RETAIL	61	OIL & GAS	-52
COMMERCIAL SVCS. & SUPPLIES	57	INDUSTRIAL CONGLOMERATES	-33
HOUSEHOLD DURABLES	57	ENERGY EQUIP. & SVCS.	-32
FOOD & DRUG RETAILING	55	ELECTRIC UTILITIES	-9
BANKS	48	MARINE TRANSPORT	-4

ALL INDUSTRY AVERAGE: 57%

COMPANIES

WHO MADE THE MOST		WHO LOST THE MOST	
MILLIONS OF DOLLARS		MILLIONS OF DOLLARS	
VERIZON COMMUNICATIONS	\$4408	LUCENT TECHNOLOGIES***	-\$2809
PHILIP MORRIS	4359	SOLETRON***	-2647
GENERAL ELECTRIC	4087	SANMINA-SCI***	-2607
CITIGROUP	3706	AMGEN	-2602
MICROSOFT*	2726	OWENS CORNING	-2359
EXXON MOBIL	2640	AT&T WIRELESS SVCS.	-2049
PFIZER	2350	HEWLETT-PACKARD	-2029
BANK OF AMERICA	2235	TYCO INTERNATIONAL***	-1701
WAL-MART STORES**	2038	OYNEGY	-1246
MERCK	1884	AMR	-924
AIG	1841	CHEVRONTXACO	-904
JOHNSON & JOHNSON	1817	UAL	-889
SBC COMMUNICATIONS	1770	AGERE SYSTEMS***	-885
IBM	1694	CIGNA	-877
PROCTER & GAMBLE*	1464	GENERAL MOTORS	-804

*Fiscal first quarter **Fiscal second quarter ***Fiscal fourth quarter



Scoreboard. Terrorist attacks turned what was already a tough quarter into a black hole for much of Corporate America. Many companies in battered sectors such as telecom and technology took the opportunity to do some extra bloodletting. Motorola Inc., for instance, took a \$2 billion pretax charge, mostly for bad debt, and lost \$1.4 billion. This quarter, it made \$111 million.

Still, despite all the special items, the third quarter delivered some of the first good earnings news in a long time. The 5% sales increase is the best since the second quarter of 2001, and compares with an average 2% drop through the previous four quarters. Strip out all the one-time hits, and third-quarter profits still rose 8% above the year-ago level. True, profit margins, at 4.8%, remained below the first quarter 1998 peak of 5.5%. But all in all, it's enough to convince many observers that earnings have bottomed out. The numbers "are getting better each quarter by an expanding margin," says Charles L. Hill, research director at Thomson First Call. "It's just a slowly expanding margin." First Call predicts that, for companies in the Standard & Poor's 500-stock index, operating earnings—before special charges and extraordinary items—will grow 15% in the current period.

The question is whether consumer witters will cause the economy to sputter in the fourth quarter—and whether corporate profits will be dragged down again. After all, it was largely shoppers buying new cars that helped drive third-quarter growth in gross domestic product to 3.1%, up from 1.3% in the previous period. Now, however, consumer confidence has fallen sharply. Consumer spending fell 0.4% in September, and auto sales slumped 27% in October. Economists, who had been expecting GDP growth of 2.2% in the fourth quarter, reduced estimates following the negative reports.

That has dire implications for some of the sectors that turned in the strongest performances last quarter. As a group, specialty retailers registered an 11% sales increase and a 61% profit gain. Leading the pack were such sector-dominating players as home-improvement twins Lowe's Co. and Home Depot Inc., which had profits that were 42% and 28% higher, respectively. Wal-Mart Stores Inc. led multiline retailers with a 26% rise in profits, to \$2 billion. The housing boom played a big role in who won: Maytag Corp. reported a 63% profit leap, to \$61 million, thanks to sales of high-end products such as super-capacity dishwashers. "Those who have the money buy what they want," says Ralph F. Hake, Maytag chairman and CEO.

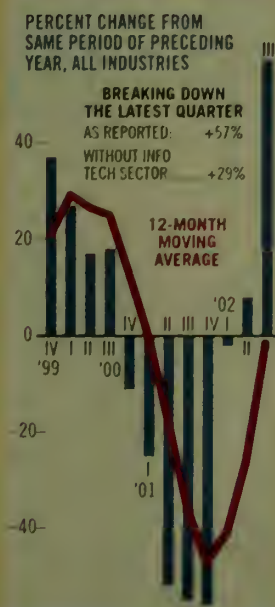
The folks buying new appliances probably used credit cards. Those pur-

chases, plus the surge in mortgage lending and refinancing, gave a boost to banks with strong consumer-credit arms, such as Bank of America, based in Charlotte, N.C. BofA has benefited by steadily shifting its business from low-margin wholesale loans to high-margin consumer loans. The bank also avoided losses on the corporate side by cutting nearly half its \$110 billion loan portfolio, including much of its exposure to telecom and energy. This portfolio-scouring helped BofA post a profit jump of 166%, to \$2.2 billion, although the gain is partly due to a \$1.7 billion pretax charge that BofA took a year ago, when it exited the subprime lending business.

Much of the earnings improvement was made through corporate cost-cutting, of course. That is bad news for companies trying to sell new industrial

A Spotlight on the Third Quarter

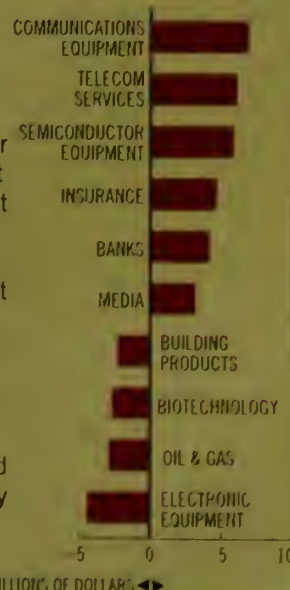
AFTERTAX PROFITS QUARTER BY QUARTER



INDUSTRIES WITH THE BIGGEST DOLLAR CHANGE IN THE QUARTER

The 57% boost in earnings is the best since the fourth quarter of 1994. Perhaps even better is the 6% jump in revenue, considering that sales have gone down an average of 2% per quarter for the previous 12 months. But it still isn't at the double digit level we saw eight quarters in a row, ending in the first quarter of 2001. On the profit side, most of the gain is because the third quarter of 2001 was so lousy. The communications equipment sector, for instance, had a \$6.8 billion dollar turnaround this quarter, and the industry still lost \$2.7 billion. But beggars can't be choosers.

CHANGE IN AFTERTAX PROFITS FROM 2001



Data: Standard & Poor's COMPUSTAT

and technology gear. Many tech and telecom-equipment companies continue to slash staff. Telecom-gear maker Lucent Technologies Inc., which is laying off 10,000 people, recorded the biggest loss of any company in the third quarter—\$2.8 billion. It was a big improvement, though, over last year's \$7.3 billion loss.

At some point, of course, all the cost-cutting should pave the way for an earnings rebound. Take Verizon Communications, the telecom giant that recorded the single highest profit for the quarter—\$4.4 billion, more than double its year-ago

WHY WE REGROUPED

A lot has changed in the past 14 years, and it's time for *BusinessWeek's* Scoreboard to recognize that. Starting this quarter, we've changed the way we classify companies, adopting categories such as Internet & Catalog Retailing that didn't even exist when the Scoreboard began in the 1970s—or when it was last updated, in 1988. The new system was developed by Standard & Poor's (which, like *BusinessWeek*, is owned by The McGraw-Hill Companies) and Morgan Stanley Capital International.

The other advantage of this grouping is that it sweeps earnings data into broad categories reflecting key economic sectors: consumer discretionary spending, finance, information technology, and so on. Below each broad category are data about industry groups and the companies within them. All in all, it's a more complete picture of who's making money—and who isn't.

level. No one believes the telecom turnaround is at hand: Verizon's revenues rose only 1%, to \$17.2 billion. But it was able to bolster its bottom line by slashing costs—it cut capital spending by 21%,

double-dip downturn, investors may look back on this quarter as a turning point.

By Faith Keenan in Boston with Dean Foust in Atlanta and Michael Arndt in Chicago

to \$2.6 billion, in the quarter.

Companies also continue to benefit from productivity growth as they rejigger processes and make smarter use of years of IT investments. And eventually, as aging equipment grows creaky, companies will have to replace it. Sometime in 2003, corporate house cleaning should be largely complete. As long as we don't get

WHAT'S AILING COMPANIES: MEDICAL BILLS

With fierce competition ensuring razor-thin margins—and limiting companies' ability to raise prices—execs will continue to seek ways to cut expenses. But one area where costs figure to keep swelling is health-care coverage.

While the Labor Dept. recently reported that overall worker pay and benefits are up only 3.7% from a year ago, unpublished estimates show employer health-benefit costs surged an estimated 11.2%. And that pace is expected to accelerate next year. Management consultant Towers Perrin estimates that health-plan costs for large companies will jump 15% in 2003 (chart). That would boost the average total cost to \$9,216 per employee with family coverage. Those spiraling costs can quickly subtract from earnings.

The burden won't be felt equally across Corporate America, though. "The biggest hit is being taken by companies that have older workers with more heavily unionized contracts," says Standard & Poor's chief economist David A. Wyss. That includes industries such as manufacturers, utilities, and telecom. Ford Motor Co. shells out \$2.5 billion for health coverage for 620,000 current and retired employees and dependents. One reason for the hefty bill: While the average company picks up 80% of insurance costs, the auto

maker pays 100% of the premium for its hourly workers. And for the most part, Ford's hands will be tied until at least next September when the latest contract with the United Auto Workers comes up for renewal.

What's fueling health-care inflation are new drugs and medical technologies, greater utilization of new technology by doctors, and the consolidation of health-care companies, which have more power to force price hikes. Insurers pass along those cost increases and then some. In response, more employers plan to raise co-payments and deductibles and increase the portion of premiums paid by employees. And they have more leverage to do so—with the unemployment rate up to 5.7% in October, valued workers are less likely to bolt for another job.

Still, companies are being forced to find other ways to combat the rise in health costs. More employers, including Bank of America, are rolling out free voluntary education-and-treatment services for employees and dependents with chronic conditions such as diabetes. Those employees, on average, account for roughly 75%

of claims paid out. The upshot is less emergency care and better work attendance, which means companies can "affect the bottom line while also improving the quality of care," says Blaine Bos, a principal at Mercer Human Resource Consulting LLC. Prescription drugs are another area

where companies are looking to save. Ford is working with insurers to encourage doctors to prescribe the same daily dosage in fewer pills.

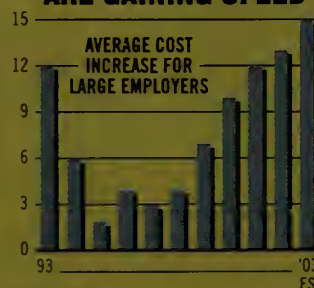
Insurers, hospital groups, and makers of high-tech medical gear will continue to be the big winners from the rise in health costs. Boston Scientific Corp., which

just introduced a new artery stent, forecasts double-digit sales gains for the "foreseeable future."

Eventually, the economy will pick up enough to alleviate the strain that health care is putting on bottom lines. But until then, businesses mired in slow growth will be under increasing pressure to squeeze out productivity gains and hold down hiring. One way or another, rising costs of health care will continue to be a bitter pill for most employers.

By James Mehring in New York

HEALTH-CARE COSTS ARE GAINING SPEED



▲ PERCENT
Data: Towers Perrin

Third Quarter 2002

CORPORATE SCOREBOARD

Glossary

SALES: Includes all sales and other operating revenues. For banks, includes all operating revenues.

PROFITS: Net income before extraordinary items. For banks,

profits are net income after security gains or losses.

MARGINS: Net income from continuing operations before extraordinary items as percent of sales.

RETURN ON COMMON EQUITY: Ratio of net income available

for common stockholders (most recent 12 months) to latest available common equity, which includes common stock, capital surplus, and retained earnings.

PRICE-EARNINGS RATIO: Based on Oct. 31, 2002, common-

stock price and corporate earnings from continuing operations before extraordinary items for most recent 12-month period.

EARNINGS PER SHARE: For most recent 12-month period. Includes all common-stock equivalents.

COMPANY SYMBOL	SALES				PROFITS				MARGINS		RETURN ON COMMON EQUITY 12 MONTHS ENDING 9-30	PRICE- EARNINGS RATIO 10-31	12 MONTHS' EARNINGS PER SHARE
	3RD QUARTER 2002 \$ MIL.	CHANGE FROM 2001 %	9 MONTHS 2002 \$ MIL.	CHANGE FROM 2001 %	3RD QUARTER 2002 \$ MIL.	CHANGE FROM 2001 %	9 MONTHS 2002 \$ MIL.	CHANGE FROM 2001 %	3RD QUARTER 2002 %	3RD QUARTER 2001 %			
ALL-INDUSTRY COMPOSITE	1789680.4	6	5245381.2	1	86507.5	57	235387.7	14	4.8	3.3	8.8	30	0.95
CONSUMER DISCRETIONARY SECTOR													
SECTOR COMPOSITE	449315.8	8	1347233.7	7	13195.2	127	37377.1	71	2.9	1.4	6.2	36	0.77
1 AUTOMOBILES & COMPONENTS													
INDUSTRY GROUP COMPOSITE	121298.6	7	376317.6	4	-384.2	NM	2862.8	773	NM	NM	-4.9	NM	-0.55
(A) AUTO COMPONENTS													
INDUSTRY COMPOSITE	36233.4	7	111293.8	4	548.7	NM	1488.5	NM	1.5	NM	2.9	54	0.33
AMERICAN AXLE & MFG. HOLOINGS AXL	828.7	11	2569.2	11	36.5	43	123.9	48	4.4	3.4	22.4	8	3.01
AUTOLIV ALV	1066.5	17	3264.6	8	41.4	NM	132.9	521	3.9	NM	8.0	12	1.62
BANDAG 8DG	245.9	-5	669.5	-5	19.6	34	32.5	23	8.0	5.7	12.1	16	2.46
BORGWARNER 8WA	684.0	22	2030.3	15	31.9	73	109.1	70	4.7	3.3	11.3	11	4.15
COOPER TIRE & RUBBER CT8	839.3	6	2488.3	5	23.3	NM	88.4	NM	2.8	NM	10.5	9	1.41
OANA DCN	2610.0**	5	8050.0	0	4.0	-69	47.0	NM	0.2	0.5	-15.0	NM	-1.69
OELPHI DPH	6446.0	3	20456.0	4	54.0	108	223.0	NM	0.8	0.4	3.9	41	0.17
DURA AUTOMOTIVE SYSTEMS DRRA	586.8	3	1870.3	-1	4.0	NM	10.6	-43	0.7	NM	0.7	56	0.15
FEDERAL SIGNAL FSS	261.6	3	765.1	-4	12.5	41	33.0	-11	4.8	3.5	11.3	18	0.95
GOODYEAR TIRE & RUBBER GT	3529.6	-4	10319.6	-3	33.7	262	-0.6	NM	1.0	0.3	-6.0	NM	-1.08
HAYES LEMMERZ INTERNATIONAL HLMMQ ⁽¹¹⁾	504.0	-3	1455.4	-5	-28.0	NM	-271.0	NM	NM	NM	NM	NM	-11.44
JOHNSON CONTROLS JCI ⁽³⁾	5218.2	12	15285.7	9	190.5	22	480.6	28	3.7	3.4	20.3	12	6.35
LEAR LEA	3337.4	7	10664.2	4	61.6	292	193.5	158	1.8	0.5	9.7	17	2.13
MOORE MFG. MODI ⁽⁹⁾	275.6	3	802.8	-2	6.3	-8	21.7	-2	2.3	2.5	4.4	26	0.68
TENNECO AUTOMOTIVE TEN	856.0	5	2613.0	0	5.0	NM	22.0	NM	0.6	NM	-72.6	NM	-2.00
TOWER AUTOMOTIVE TWR	653.8	17	2072.8	13	9.5	NM	-2.1	NM	1.5	NM	-54.5	NM	-6.19
TRW TRW	3946.0	10	12065.0	5	95.0	NM	297.0	NM	2.4	NM	19.3	17	3.05
VISTEON VC	4344.0	17	13852.0	4	-52.0	NM	-53.0	NM	NM	NM	-2.2	NM	-0.52
(B) AUTOMOBILES													
INDUSTRY COMPOSITE	85065.3	6	265023.8	4	-933.0	NM	1374.3	335	NM	NM	-10.5	NM	-1.12
FORD MOTOR F	39580.0	9	121736.0	1	-326.0	NM	152.0	NM	NM	NM	-49.3	NM	-2.73
GENERAL MOTORS GM	43578.0**	3	138107.0	5	-804.0	NM	716.0	107	NM	NM	4.9	15	2.23
HARLEY-DAVIDSON HDI	1191.2**	31	3221.9	22	165.0	48	429.4	34	13.9	12.3	25.7	29	1.80
MONACO COACH MNC	314.7	31	922.0	36	11.8	78	32.4	87	3.7	2.8	16.2	12	1.36
THOR INDUSTRIES THO ⁽⁵⁾	401.4	81	1036.8	69	20.2	140	44.5	143	5.0	3.8	15.3	18	1.88
2 CONSUMER DURABLES & APPAREL													
INDUSTRY GROUP COMPOSITE	45940.1	8	126589.9	7	2981.9	54	7120.1	63	6.5	4.5	16.5	15	1.95
(A) HOUSEHOLD DURABLES													
INDUSTRY COMPOSITE	28148.4	11	79837.0	11	1484.3	57	4323.7	85	5.3	3.7	17.8	13	2.39
AMERICAN GREETINGS AM ⁽¹⁰⁾	396.9	0	1537.5	6	-15.8	NM	15.6	NM	NM	NM	2.3	49	0.31
BLACK & DECKER BDK	1085.2	4	3162.2	4	54.9	19	154.0	27	5.1	4.4	15.3	27	1.74
BLUTH 8TH ⁽¹¹⁾	268.0	9	914.5	9	18.8	46	49.7	25	7.0	5.2	15.4	17	1.62
CTX CTX ⁽⁹⁾	2083.8**	11	6188.8	11	115.6	24	320.8	17	5.5	5.0	18.1	7	6.60

(1) Third quarter ended Aug. 31. (2) Third quarter ended July 30. (3) Fourth quarter and most recent nine months ended Sept. 30. (4) Fourth quarter and most recent nine months ended Aug. 31. (5) Fourth quarter and most recent nine months ended July 31. (6) First quarter and most recent nine months ended Sept. 30. (7) First quarter and most recent nine months ended Aug. 31. (8) First quarter and most recent nine months ended July 31. (9) Second quarter and most recent nine months ended Sept. 30. (10) Second quarter and most recent nine months ended Aug. 31. (11) Second quarter and most recent nine months ended July 31. *Sales include excise taxes. **Sales include other income. ***Sales include excise taxes and other income. †Revenues from major subsidiaries not included in consolidated sales. Earnings per share are for latest 12 months, not necessarily for end of most recent fiscal year; they include all common-stock equivalents but exclude extraordinary items. NA = not available. NM = not meaningful.

Data: Standard & Poor's COMPUSTAT

CORPORATE SCOREBOARD

COMPANY SYMBOL	SALES				PROFITS				MARGINS		RETURN ON COMMON EQUITY 12 MONTHS ENDING 9-30	PRICE-EARNINGS RATIO 10-31	12 MONTHS' EARNINGS PER SHARE
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CHAMPION ENTERPRISES CH8	374.1	-13	1042.0	-12	-38.9	NM	-250.1	NM	NM	0.6	NM	NM	-5.25
CLAYTON HOMES CMH ⁽⁶⁾	306.9	4	912.6	6	29.6	12	93.5	22	9.7	8.9	10.0	12	0.92
FLEETWOOD ENTERPRISES FLE ⁽⁸⁾	611.3	8	1736.8	7	-1.5	NM	-59.3	NM	NM	NM	-40.2	NM	-1.26
FORTUNE BRANDS FO	1387.5	3	4022.0	4	113.2	22	394.1	53	8.2	6.9	22.0	15	3.39
FURNITURE BRANDS INTERNATIONAL F8N	563.2	26	1802.2	27	24.7	78	89.5	154	4.4	3.1	13.0	11	1.98
HARMAN INTERNATIONAL INDUSTRIES HAR ⁽⁶⁾	490.8	23	1450.5	13	9.8	95	50.6	743	2.0	1.3	11.9	31	1.83
HOVNANIAN ENTERPRISES HOV ⁽²⁾	704.6**	38	1719.7	43	39.2	86	83.8	100	5.6	4.1	20.8	11	3.37
KB HOME KBH ⁽¹⁾	1293.0	5	3348.3	7	83.9	39	190.6	52	6.5	4.9	24.7	7	6.32
KIMBALL INTERNATIONAL K8AL8 ⁽⁶⁾	290.1	2	880.2	-1	4.6	-6	27.7	NM	1.6	1.7	7.6	17	0.90
LA-Z-BOY LZ8 ⁽⁸⁾	497.4	9	1637.0	2	19.1	576	65.7	124	3.8	0.6	12.6	19	1.28
LEGGETT & PLATT LEG	1121.2	6	3259.2	4	57.7	4	184.2	21	5.1	5.2	11.2	19	1.10
LENNAR LEN ⁽¹⁾	1856.6**	18	4663.1	15	142.2	33	320.1	26	7.7	6.8	24.2	8	6.87
M.O.C. HOLDINGS MOC	581.5	12	1546.8	7	43.6	7	110.2	1	7.5	7.8	20.8	7	5.68
MAYTAG MYG	1168.0	3	3538.6	15	61.0	63	187.4	30	5.2	3.3	101.2	10	2.69
MERITAGE MTH	329.1**	59	750.3	50	22.4	53	45.9	31	6.8	7.1	21.6	8	4.89
MI SCHOTTENSTEIN HOMES MHO	261.5	-2	735.5	10	17.9	19	50.7	34	6.8	5.6	19.7	8	4.24
MOHAWK INDUSTRIES MHK	1224.4	35	3318.9	30	81.6	46	200.3	55	6.7	6.1	13.7	13	4.24
NEWELL RUBBERMAID NWL	1948.3	10	5440.3	7	76.2	-9	215.7	11	3.9	4.7	14.0	30	1.07
NVR NVR	867.2**	25	2347.9	24	92.0	47	252.5	49	10.6	9.0	89.6	10	34.57
PILLOWTEX PWTX	242.5	-9	693.9	-10	-9.3	NM	326.3	NM	NM	NM	148.8	NA	NA
PULTE HOMES PHM	1859.5**	25	4923.8	46	113.5	37	272.6	49	6.1	5.6	15.1	7	6.41
RYLAND GROUP RYL	732.7	3	1947.5	2	47.4	27	118.1	35	6.5	5.2	25.8	7	5.79
SNAP-ON SNA	512.7**	-1	1586.0	0	19.2	NM	70.1	80	3.7	0.1	6.2	29	0.90
STANARO PACIFIC SPF	465.3	38	1201.9	26	22.6	-14	66.4	-17	4.9	7.8	13.2	8	3.12
STANLEY WORKS SWK	665.5	-1	1931.3	-2	54.7	0	166.9	10	8.2	8.1	17.8	16	1.97
TOLL BROTHERS TOL ⁽²⁾	580.5**	0	1621.6	4	53.5	-10	150.5	4	9.2	10.2	20.7	7	2.91
TORO TTC ⁽²⁾	375.6**	14	1123.9	5	21.9	29	54.9	14	5.8	5.1	15.7	14	4.41
TUPPERWARE TUP	244.3	2	782.3	-1	8.0	NM	55.6	68	3.3	NM	53.8	11	1.43
WHIRLPOOL WHR	2759.0	6	8070.0	5	101.0	NM	249.0	NM	3.7	NM	30.9	12	3.89
(B) LEISURE EQUIPMENT & PRODUCTS													
INDUSTRY COMPOSITE	7460.7	3	19132.5	-1	718.0	81	1135.1	75	9.6	5.5	14.8	21	1.09
BRUNSWICK 8C	900.0	11	2783.9	5	23.6	275	83.0	-5	2.6	0.8	6.5	23	0.89
EASTMAN KODAK EK	3354.0	1	9400.0	-5	334.0	248	657.0	133	10.0	2.9	14.5	21	1.54
HASBRO HAS	820.5	-8	1818.8	-3	55.8	10	12.9	55	6.8	5.7	5.7	28	0.37
MATTEL MAT	1669.4	6	3215.8	3	253.3	27	268.9	56	15.2	12.7	22.2	20	0.92
POLARIS INDUSTRIES PII	428.0	1	1089.8	2	37.1	15	68.5	15	8.7	7.6	37.4	15	4.24
SCP POOL POOL	288.8	23	824.2	14	14.2	11	44.7	14	4.9	5.4	27.8	18	1.58
(C) TEXTILES, APPAREL & LUXURY GOODS													
INDUSTRY COMPOSITE	10330.9	3	27620.4	1	779.6	33	1661.3	19	7.5	5.9	14.3	18	1.93
BROWN SHOE 8WS ⁽¹¹⁾	456.3	3	1318.3	3	7.2	24	-8.3	NM	1.6	1.3	1.3	NM	0.17
COLUMBIA SPORTSWEAR COLM	331.5	8	599.0	6	56.9	15	73.4	14	17.2	16.2	22.4	16	2.44
JONES APPAREL GROUP JNY	1277.5	3	3376.4	5	129.8	144	280.7	37	10.2	4.3	13.7	15	2.31
KELLWOOD KWD ⁽¹¹⁾	463.3	-8	1504.0	-14	3.9	114	9.3	-63	0.8	0.4	4.3	24	0.99
LIZ CLAIBORNE LIZ	1041.2	3	2723.6	6	83.5	15	173.2	15	8.0	7.2	18.6	15	2.01
NIKE NKE ⁽⁷⁾	2796.3	7	7738.8	6	217.2	6	552.0	19	7.8	7.8	18.6	19	2.52
PHILLIPS-VAN HEUSEN PVH ⁽¹¹⁾	331.2	-1	1006.2	-6	7.9	13	-2.4	NM	2.4	2.1	3.7	38	0.36
REEBOK INTERNATIONAL R8K	911.6	8	2365.0	2	53.4	26	115.0	18	5.9	5.0	14.2	15	1.87
RUSSELL RML	387.0	10	855.9	1	23.4	NM	32.5	NM	6.0	NM	0.4	NM	0.04
SKECHERS U.S.A. SKX	261.1	-9	762.7	2	14.1	24	55.6	23	5.4	4.0	21.7	7	1.45
TIMBERLAND TBL	416.6	5	833.9	-1	49.2	1	63.1	-18	11.8	12.2	25.2	13	2.41
VF VFC	1400.4**	0	3772.9	-5	128.6	25	294.1	18	9.2	7.3	10.2	23	1.57
WELLMAN WLM	256.8	2	763.7	-3	4.7	12	23.1	75	1.8	1.7	5.4	14	0.70
3 HOTELS RESTAURANTS & LEISURE													
INDUSTRY GROUP COMPOSITE	22811.4	6	65276.5	4	2114.2	28	5167.8	20	9.3	7.7	12.3	17	1.22
ARGOSY GAMING AGY	239.8	11	719.9	30	19.1	11	55.1	21	8.0	7.9	32.9	8	2.57
BOB EVANS FARMS 808E ⁽⁸⁾	277.0	4	800.3	5	20.6	37	54.4	42	7.4	5.6	13.5	12	2.06
BOYO GAMING 8YD	308.0	13	922.8	11	11.3	174	44.3	139	3.7	1.5	12.9	14	0.78
BRINKER INTERNATIONAL EAT ⁽⁶⁾	773.9	15	2302.6	19	45.0	14	123.4	5	5.8	5.9	16.2	18	1.58
CARNIVAL CCL ⁽¹⁾	1437.7	-4	3332.6	-7	500.8	1	824.6	2	34.8	33.2	12.9	16	1.60
CBRL GROUP CBRL ⁽⁵⁾	544.1	0	1571.7	5	30.5	NM	72.1	124	5.6	0.5	11.7	14	1.64
CKE RESTAURANTS CKR ⁽¹¹⁾	337.2	-1	1072.8	-8	10.8	NM	15.6	NM	3.2	NM	7.3	18	0.22
DARREN RESTAURANTS DRI ⁽⁷⁾	1174.6	9	3461.9	11	71.9	16	211.1	22	6.1	5.8	21.2	14	1.36
DENNY'S DNY	246.9	-9	721.7	-9	-0.4	NM	11.1	NM	NM	NM	NM	NM	-0.71
HARRAH'S ENTERTAINMENT HET	1133.8	13	3147.8	15	101.0	63	272.3	77	8.9	6.1	23.0	15	2.88
HILTON HOTELS HLT	934.0	-1	2890.0	-7	48.0	129	158.0	-2	5.1	2.2	8.2	29	0.43
ISLE OF CAPRI CASINOS ISLE ⁽⁸⁾	276.7	5	843.9	9	12.2	108	0.2	-98	4.4	2.2	6.3	41	0.31
LANORY'S RESTAURANTS LNY	241.1	19	665.2	13	15.7	49	36.9	49	6.5	5.2	6.9	15	1.49
MANOALAY RESORT GROUP MBG ⁽¹¹⁾ †	600.5	-2	1723.9	-5	29.3	-4	31.9	-61	4.9	5.0	5.4	36	0.79
MARRIOTT INTERNATIONAL MAR	2454.0	3	7404.0	2	103.0	2	314.0	-11	4.2	4.3	5.3	41	0.75

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CORPORATE SCOREBOARD

COMPANY SYMBOL	SALES				PROFITS				MARGINS		RETURN ON COMMON EQUITY 12 MONTHS ENDING 9-30	PRICE-EARNINGS RATIO 10-31	12 MONTHS' EARNINGS PER SHARE
	3RD QUARTER 2002 \$ MIL.	CHANGE FROM 2001 %	9 MONTHS 2002 \$ MIL.	CHANGE FROM 2001 %	3RD QUARTER 2002 \$ MIL.	CHANGE FROM 2001 %	9 MONTHS 2002 \$ MIL.	CHANGE FROM 2001 %	3RD QUARTER 2002 %	3RD QUARTER 2001 %			
MCDONALD'S MCD	4047.0	4	11506.5	4	486.7	-11	1335.9	-2	12.0	14.1	15.5	14	1.25
MGM MIRAGE MGG	1004.6	2	3048.6	-1	69.9	NM	253.7	73	7.0	NM	10.1	18	1.73
OUTBACK STEAKHOUSE OSI	584.2	10	1759.4	11	35.8	41	119.7	20	6.1	4.8	14.9	18	1.93
PARK PLACE ENTERTAINMENT PPE	1215.0	2	3571.0	1	40.0	NM	176.0	NM	3.3	NM	5.4	14	0.52
ROYAL CARIBBEAN CRUISES RCL	1031.7	10	2653.4	7	193.5	22	313.0	7	18.8	16.9	7.2	13	1.40
STARWOOD HOTELS & RESORTS HOT	970.0	1	2896.0	-6	52.0	73	160.0	-20	5.4	3.1	2.6	47	0.50
TRUMP HOTELS & CASINO RESORTS DJT	342.6	5	946.0	6	9.6	1	5.3	NM	2.8	2.9	-5.8	NM	-0.22
WENOV'S INTERNATIONAL WEN	722.1	18	2018.6	14	60.9	16	168.1	14	8.4	8.6	15.2	17	1.87
YUM! BRANDS YUM	1915.0	17	5296.0	11	147.0	19	411.0	25	7.7	7.6	107.9	12	1.86

4 MEDIA

INDUSTRY GROUP COMPOSITE	37254.1	9	108354.2	8	1986.6	NM	4533.6	NM	5.3	NM	1.1	NM	0.20
ADO AD ⁽³⁾	287.8	1	843.2	0	11.4	-21	29.9	-17	3.9	5.0	145.6	15	2.07
AMC ENTERTAINMENT AEN ⁽⁹⁾	451.1	20	1251.3	28	-2.8	NM	-13.3	NM	NM	5.0	-17.4	NM	-1.98
AOL TIME WARNER AOL	9983.0	10	29641.0	10	-55.0	NM	331.0	NM	NM	NM	-1.5	NM	-0.34
BELO BLC	347.6	8	1033.7	2	28.0	NM	85.3	NM	8.1	NM	5.9	31	0.74
CLEAR CHANNEL COMMUNICATIONS CCU	2340.4	2	6211.3	2	212.5	NM	540.9	NM	9.1	NM	1.3	NM	0.27
COMCAST CMCSK	2704.7	13	8086.1	16	75.6	NM	-222.9	NM	2.8	NM	-3.9	NM	-0.57
COX COMMUNICATIONS COX	1275.0	18	3697.7	19	-73.1	NM	-453.7	NM	NM	13.2	-5.9	NM	-0.93
DOW JONES DJ	352.4	-11	1162.3	-13	2.4	-85	186.3	182	0.7	4.2	167.4	14	2.58
GANNETT GCI	1580.9	4	4729.8	0	265.6	52	813.1	40	16.8	11.5	16.9	19	3.96
HUGHES ELECTRONICS GMH	2214.2	5	6462.1	8	-13.6	NM	-325.1	NM	NM	NM	-5.5	NM	-0.39
KNIGHT-RIDDER KRI	689.0	-1	2082.3	-4	56.5	2	185.1	69	8.2	8.0	16.8	20	3.05
McCLATCHY MNI	267.1	1	794.0	-1	32.6	129	92.2	148	12.2	5.4	10.7	25	2.46
McGRAW-HILL MHP	1577.3	3	3615.4	2	276.2	15	441.9	16	17.5	15.6	20.2	29	2.26
MEREOITH MDP ⁽⁶⁾	250.1	6	773.4	0	16.5	90	90.5	129	6.6	3.7	23.1	23	1.94
METRO-GOLDWYN-MAYER MGM	381.2	-3	1033.2	2	11.7	NM	-200.9	NM	3.1	NM	-6.6	NM	-0.65
NEW YORK TIMES NYT	729.5	5	2238.8	0	59.0	35	192.2	50	8.1	6.3	21.2	28	1.72
OMNICOM GROUP OMC	1768.5	13	5417.5	10	126.1	37	442.0	30	7.1	5.9	27.5	18	3.23
READER'S DIGEST ASSOCIATION RDA ⁽⁶⁾	517.1	4	1604.2	-2	-5.2	NM	8.3	69	NM	NM	19.3	19	0.86
REGAL ENTERTAINMENT GROUP RGC	571.5	260	1593.8	403	36.1	492	87.0	NM	6.3	3.8	4.8	NA	NA
SCHOLASTIC SCHL ⁽⁷⁾	306.9	0	1280.6	3	-44.6	NM	19.4	NM	NM	NM	12.7	21	2.14
SCRIPPS (E.W.) SSP	371.5	11	1131.2	6	45.7	102	112.5	-12	12.3	6.7	8.5	51	1.52
TRIBUNE TRB	1340.5	5	3954.7	0	236.8	NM	415.0	NM	17.7	NM	9.3	31	1.55
VIACOM VIA.8	6306.5	10	17828.2	4	640.3	NM	1554.2	NM	10.2	NM	2.4	52	0.86
WASHINGTON POST WPO	640.3	8	1888.3	6	47.8	NM	122.6	-43	7.5	0.3	8.0	51	14.30

5 RETAILING

INDUSTRY GROUP COMPOSITE	222011.6	9	670695.5	8	6496.7	53	17692.9	20	2.9	2.1	11.7	29	1.04
(A) DISTRIBUTORS													
INDUSTRY COMPOSITE	1646.8	-7	5227.9	-5	17.8	NM	41.7	-10	1.1	0.1	9.2	8	0.71
CELLSTAR CLST ⁽¹⁾	523.0	-14	1725.5	-6	6.1	NM	0.6	-68	1.2	NM	-0.1	NM	-0.02
HANDLEMAN HDL ⁽⁸⁾	271.0	4	992.1	7	2.7	32	22.0	-22	1.0	0.8	12.8	7	1.40
WESCO INTERNATIONAL WCC	852.9	-6	2510.3	-10	9.0	76	19.1	19	1.1	0.6	14.1	8	0.50
(B) INTERNET & CATALOG RETAIL													
INDUSTRY COMPOSITE	3484.6	44	9241.4	30	58.0	NM	-53.6	NM	1.7	NM	-0.8	NM	-0.06
AMAZON.COM AMZN	851.3	33	2504.3	25	-35.1	NM	-152.6	NM	NM	NM	NM	NM	-0.39
EBAY EBAY	288.8	49	800.2	51	61.0	224	162.9	153	21.1	9.7	10.4	96	0.66
INSIGHT ENTERPRISES NSIT	854.0	74	2119.0	36	10.1	22	35.3	5	1.2	1.7	7.9	10	0.79
SCHOOL SPECIALTY SCHS ⁽⁸⁾	298.0	15	535.6	8	24.0	46	10.1	148	8.0	6.3	9.8	20	1.19
USA INTERACTIVE USAI	1192.5	42	3282.2	30	-2.0	NM	-109.3	NM	NM	NM	-2.2	NM	-0.40
(C) MULTILINE RETAIL													
INDUSTRY COMPOSITE	127430.7	8	390307.5	7	2931.0	29	7666.6	-8	2.3	1.9	11.1	36	1.09
BIG LOTS BL ⁽¹¹⁾	879.3	17	2921.6	11	3.2	NM	13.5	-77	0.4	NM	-0.3	NM	-0.03
BJ'S WHOLESALE CLUB BJ ⁽¹¹⁾	1486.0	14	4321.0	9	35.9	-2	115.3	1	2.4	2.8	11.9	18	1.13
COSTCO WHOLESALE COST ⁽⁴⁾	12296.3**	10	30295.9	12	247.4	30	570.3	21	2.0	1.7	12.9	23	1.48
OILLARD'S DDS ⁽¹¹⁾	1885.7**	0	6455.0	-2	12.5	NM	171.0	165	0.7	NM	5.9	11	1.54
OOLLAR GENERAL DG ⁽¹¹⁾	1453.7	19	4429.2	14	42.4	56	185.7	496	2.9	2.2	20.5	20	0.69
DOLLAR TREE STORES DLTR	513.5	15	1501.7	18	19.9	37	67.7	44	3.9	3.3	18.7	21	1.26
FAMILY DOLLAR STORES FDO ⁽⁴⁾	1058.3	15	3185.5	12	41.9	23	166.7	13	4.0	3.7	18.8	25	1.25
FEDERATED DEPARTMENT STORES FD ⁽¹¹⁾	3486.0**	0	12071.0	-5	133.0	7	532.0	-9	3.8	3.6	9.8	11	2.77
FRED'S FRED ⁽¹¹⁾	256.5	22	788.8	19	3.7	73	18.2	48	1.4	1.0	10.0	30	0.92
KMART KM ⁽¹¹⁾	7519.0	-16	26036.0	-10	-397.0	NM	-3588.0	NM	NM	NM	NM	NM	-7.63
KOHL'S KSS ⁽¹¹⁾	1921.8	27	6516.6	25	124.4	44	464.8	37	6.5	5.7	18.3	36	1.64
MAY DEPARTMENT STORES MAY ⁽¹¹⁾	3093.0**	-3	10909.0	-4	69.0	-38	570.0	-23	2.2	3.5	15.8	12	1.98
NEIMAN MARCUS GROUP NMGA ⁽⁵⁾	666.4**	5	2267.2	0	5.3	NM	76.6	33	0.8	NM	9.4	14	2.08
NOROSTROM JWN ⁽¹¹⁾	1690.9**	7	4630.1	2	36.3	-6	75.9	-16	2.1	2.4	6.6	31	0.65
PENNEY (J.C.) JCP ⁽¹¹⁾	7198.0	0	24468.0	1	-6.0	NM	175.0	NM	NM	NM	3.1	29	0.65
SAKS SKS ⁽¹¹⁾	1237.2**	-3	4575.4	-6	-20.4	NM	53.3	493	NM	NM	1.3	52	0.21
SEARS, ROEBUCK S	9669.0	-1	28848.0	0	189.0	-28	736.0	205	2.0	2.7	19.8	7	3.80
SHOPKO STORES SKO ⁽¹¹⁾	786.6	-1	2525.0	-7	7.2	178	42.6	NM	0.9	0.3	7.3	10	1.29

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TARGET TGT ⁽¹¹⁾	10068.0**	13	32899.0	11	344.0	27	1352.0	26	3.4	3.0	18.0	18	1.68
VALUE CITY DEPARTMENT STORES VCD ⁽¹¹⁾	571.5	6	1799.3	3	1.3	NM	-10.0	NM	0.2	NM	-7.6	NM	-0.49
WAL-MART STORES WMT ⁽¹¹⁾	59694.0	13	178864.0	14	2038.0	26	5878.0	17	3.4	3.1	19.9	32	1.65
(D) SPECIALTY RETAIL													
INDUSTRY COMPOSITE	89449.5	11	265918.7	10	3489.8	61	10038.2	43	3.9	2.7	13.5	20	1.12
ABERCROMBIE & FITCH ANF ⁽¹¹⁾	329.2	18	1108.5	13	31.1	24	133.6	9	9.5	8.9	28.3	10	1.74
AMERICAN EAGLE OUTFITTERS AEOS ⁽¹¹⁾	319.2	9	1061.4	10	10.1	-34	66.7	-17	3.2	5.2	18.6	11	1.33
ANN TAYLOR STORES ANN ⁽¹¹⁾	343.1**	11	1059.9	10	18.2	184	38.8	84	5.3	2.1	7.6	21	1.10
ASBURY AUTOMOTIVE GROUP ABG	1214.1	13	3407.6	10	14.9	-8	34.0	-1	1.2	1.5	NA	NA	NA
AUTONATION AN	5193.7	4	14960.0	1	106.7	35	302.2	34	2.1	1.6	8.0	11	0.99
AUTOZONE AZO ⁽⁴⁾	1843.3	12	4149.5	11	178.0	572	344.1	183	9.7	1.6	62.1	21	4.00
BARNES & NOBLE BKS ⁽¹¹⁾	1159.2	10	4107.5	12	1.4	NM	69.1	NM	0.1	NM	6.3	29	0.74
BED BATH & BEYOND BBY ⁽¹⁰⁾	903.0	27	2558.9	26	75.5	40	204.4	38	8.4	7.6	20.8	41	0.86
BEST BUY BBY ⁽¹⁰⁾	5008.0	20	16574.0	24	62.0	-27	482.0	46	1.2	2.0	23.6	12	1.74
BLOCKBUSTER BBI	1386.5	10	3983.5	5	51.0	NM	158.7	NM	3.7	NM	3.8	28	0.85
BORDERS GROUP BGP ⁽¹¹⁾	763.6	3	2719.8	2	3.4	NM	116.6	105	0.4	0.0	12.1	13	1.37
BUILDING MATERIALS HOLDING BMHC	316.9	-3	864.6	6	9.7	33	17.6	7	3.1	2.2	8.8	7	1.66
BURLINGTON COAT FACTORY BCF ⁽⁷⁾	506.1	12	1887.5	11	-16.1	NM	30.1	74	NM	NM	10.1	12	1.60
CARMAX KMX ⁽¹⁰⁾	1076.1	15	2856.8	16	31.7	16	79.3	29	2.9	2.9	17.6	18	0.91
CDW COMPUTER CENTERS CDWC	1151.0	16	3210.6	8	54.9	27	139.7	10	4.8	4.4	21.1	26	2.04
CHARMING SHOPPES CHRS ⁽¹¹⁾	638.3	59	1916.0	56	25.5	72	14.1	-57	4.0	3.7	2.3	58	0.08
CIRCUIT CITY STORES CC ⁽¹⁰⁾	2221.2	10	7731.1	9	9.1	34	179.3	52	0.4	0.3	7.7	10	0.96
CLAIRE'S STORES CLE ⁽¹¹⁾	238.7	8	729.5	0	15.1	NM	53.2	38	6.3	NM	12.8	22	1.15
COLE NATIONAL CNJ ⁽¹¹⁾	288.9	6	875.2	4	2.7	84	11.6	98	0.9	0.5	5.9	25	0.57
COMPUCOM SYSTEMS CMPC	414.1	2	1167.2	-19	5.5	370	12.8	157	1.3	0.3	5.9	21	0.27
CSK AUTO CAO ⁽¹¹⁾	398.3	4	1107.9	2	7.8	NM	12.8	NM	2.0	NM	6.5	23	0.55
DICK'S SPORTING GOODS DKS ⁽¹¹⁾	310.1	20	927.3	16	11.7	66	29.4	74	3.8	2.7	39.3	11	1.46
ELECTRONICS BOUTIQUE HOLDINGS ELBO ⁽¹¹⁾	262.6	38	990.8	39	0.7	NM	19.1	88	0.3	NM	9.2	30	0.83
FOOT LOCKER Z ⁽¹¹⁾	1085.0	4	3330.0	-1	33.0	725	113.0	45	3.0	0.4	13.6	10	0.99
FOOTSTAR FTS	586.8	-11	1733.7	-5	3.8	NM	-3.0	NM	0.6	NM	2.1	24	0.30
GAMESTOP GME ⁽¹¹⁾	274.3	33	1059.9	44	6.1	NM	29.8	NM	2.2	NM	6.0	27	0.66
GAP GPS ⁽¹¹⁾	3268.3	1	10248.8	-7	56.8	-37	59.3	-88	1.7	2.8	-3.8	NM	-0.14
GART SPORTS GRTS ⁽¹¹⁾	261.7	10	822.7	30	6.3	234	16.6	17	2.4	0.8	7.6	16	1.20
GOODY'S FAMILY CLOTHING GDYS ⁽¹¹⁾	284.0	-1	930.7	-2	1.3	NM	-0.8	NM	0.4	NM	-0.3	NM	-0.02
GROUP 1 AUTOMOTIVE GPI	1202.6	18	3181.8	8	20.1	27	54.8	39	1.7	1.6	16.0	7	2.94
GUITAR CENTER GTRC	257.4	13	766.1	16	4.4	218	11.9	14	1.7	0.6	13.3	23	0.80
HOLLYWOOD ENTERTAINMENT HLYW	369.0	7	1077.9	6	31.9	108	102.1	297	8.7	4.5	176.4	7	3.00
HOME DEPOT HD ⁽¹¹⁾	16277.0	12	44047.0	18	1182.0	28	2748.0	36	7.3	6.3	17.4	19	1.49
HUGHES SUPPLY HUG ⁽¹¹⁾	774.7	-4	2230.9	-4	18.5	26	36.2	202	2.4	1.8	8.6	15	2.28
JO-ANN STORES JAS.A ⁽¹¹⁾	353.7	7	1224.3	6	2.0	NM	29.6	NM	0.6	NM	7.4	26	0.93
LIMITED BRANDS LTD ⁽¹¹⁾	2112.8	-4	7277.5	-7	83.2	16	459.6	35	3.9	3.3	12.1	13	1.22
LINENS 'N THINGS LIN	542.6	16	1461.4	18	18.3	24	29.0	35	3.4	3.1	5.9	27	0.88
LITHIA MOTORS LAD	687.6	46	1796.4	33	10.7	39	25.1	60	1.6	1.6	10.0	9	1.89
LOWE'S LOW ⁽¹¹⁾	7487.7	22	19211.7	20	467.1	42	1031.3	48	6.2	5.4	16.9	26	1.62
MEN'S WEARHOUSE MW ⁽¹¹⁾	308.6	4	998.2	-5	7.8	-24	34.6	-44	2.5	3.4	7.3	15	0.93
MICHAELS STORES MIK ⁽¹¹⁾	576.6	19	2087.8	14	21.5	359	105.7	70	3.7	1.0	14.3	25	1.80
OFFICE DEPOT ODP	2870.8	4	8514.9	3	87.1	40	246.0	55	3.0	2.2	13.0	16	0.91
OFFICEMAX OMX ⁽¹¹⁾	1008.7	3	3463.7	-4	-33.4	NM	-212.9	NM	NM	NM	-32.3	NM	-2.05
O'REILLY AUTOMOTIVE ORLY	359.6	22	998.2	23	24.1	20	63.3	25	6.7	6.9	12.6	18	1.48
PAYLESS SHOESOURCE PSS ⁽¹¹⁾	776.2	-4	2156.7	-5	47.2	30	37.1	-54	6.1	4.5	9.0	23	2.18
PC CONNECTION FCCC	341.0	9	869.3	-5	2.2	8	0.4	-94	0.6	0.7	1.2	83	0.07
PEP BOYS-MANNY, MOE & JACK PBY ⁽¹¹⁾	585.8	2	1653.0	-1	16.7	36	33.9	50	2.8	2.1	7.0	14	0.84
PETCO ANIMAL SUPPLIES PETC ⁽¹¹⁾	354.5	14	1067.4	12	9.9	NM	-8.2	NM	2.8	NM	NM	NM	-0.92
PETSMART PETM ⁽¹¹⁾	651.5	12	2035.0	15	21.5	663	73.4	NM	3.3	0.5	14.3	31	0.62
PIER 1 IMPORTS PIR ⁽¹⁰⁾	410.9**	15	1273.9	14	22.1	60	93.3	49	5.4	3.9	19.8	15	1.23
RADIOSHACK RSH	1047.0	-3	3079.5	-6	44.9	3	154.3	17	4.3	4.1	26.6	20	1.02
RENT-A-CENTER RCII	494.6	11	1487.8	12	41.4	316	127.0	103	8.4	2.2	14.5	12	3.58
ROSS STORES ROST ⁽¹¹⁾	876.9	21	2544.9	17	49.7	40	147.3	28	5.7	4.9	31.3	19	2.26
RUSH ENTERPRISES RUSHB	242.9	24	616.9	3	2.9	172	5.3	98	1.2	0.5	6.8	10	0.41
SHERWIN-WILLIAMS SHW	1426.3	4	4028.6	2	111.3	23	253.6	16	7.8	6.6	22.7	14	1.95
SONIC AUTOMOTIVE SAH	1990.9	37	5417.7	23	32.2	44	86.4	47	1.6	1.5	17.0	6	2.49
SPORTS AUTHORITY TSA ⁽¹¹⁾	376.9	1	1133.0	0	9.3	28	26.6	89	2.5	2.0	13.2	9	0.66
STAPLES SPLS ⁽¹¹⁾	2426.5	5	8100.4	0	59.6	48	247.2	NM	2.5	1.7	14.8	21	0.73
TALBOTS TLB ⁽¹¹⁾	370.4**	-4	1194.9	-5	20.0	12	87.5	-4	5.4	4.6	22.9	14	2.01
TBC T8CC	295.5	6	831.9	9	7.6	28	19.3	26	2.6	2.2	11.6	10	1.14
TIFFANY TIF ⁽¹¹⁾	374.4**	1	1287.3	0	32.7	-9	148.2	-2	8.7	9.7	15.5	23	1.15
TJX TJX ⁽¹¹⁾	2765.1	11	8639.5	15	129.6	16	432.1	17	4.7	4.5	43.9	19	1.06
TOYS 'R' US TOY ⁽¹¹⁾	2070.0	2	8924.0	0	-17.0	NM	137.0	-33	NM	NM	2.5	22	0.46
TRACTOR SUPPLY TSCO	296.2	49	882.1	40	7.8	222	21.1	30	2.6	1.2	14.8	24	1.60

COMPANY SYMBOL	SALES				PROFITS				MARGINS		RETURN ON COMMON EQUITY 12 MONTHS ENDING 9-30	PRICE-EARNINGS RATIO 10-31	12 MONTHS' EARNINGS PER SHARE
	3RD QUARTER 2002 \$ MIL.	CHANGE FROM 2001 %	9 MONTHS 2002 \$ MIL.	CHANGE FROM 2001 %	3RD QUARTER 2002 \$ MIL.	CHANGE FROM 2001 %	9 MONTHS 2002 \$ MIL.	CHANGE FROM 2001 %	3RD QUARTER 2002 %	3RD QUARTER 2001 %			
TRANS WORLD ENTERTAINMENT TWMC ⁽¹¹⁾	267.5	-9	1058.0	-9	-6.4	NM	21.7	-36	NM	NM	2.3	14	0.22
UNITED AUTO GROUP UAG	2059.6	37	5557.6	28	22.6	70	60.9	85	1.1	0.9	8.6	7	1.80
UNITED RENTALS URI	783.1	-2	2126.8	-3	40.8	-34	99.5	10	5.2	7.8	9.0	4	1.36
WILLIAMS-SONOMA WSM ⁽¹¹⁾	495.6	16	1752.0	15	14.1	946	98.9	113	2.9	0.3	17.8	27	0.88
ZALE ZLC ⁽⁵⁾	435.6	3	1781.8	36	3.7	24	106.3	36	0.8	0.7	10.9	10	2.95

CONSUMER STAPLES SECTOR

SECTOR COMPOSITE	189855.9	6	563207.2	5	14915.0	40	38550.5	31	7.9	5.9	26.3	19	1.94
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6 FOOD & DRUG RETAILING

INDUSTRY GROUP COMPOSITE	75473.5	4	231664.2	3	1332.4	55	4616.0	47	1.8	1.2	15.4	21	1.05
ALBERTSON'S ABS ⁽¹¹⁾	8941.0	-3	27522.0	-1	240.0	NM	752.0	201	2.7	NM	15.8	10	2.27
CASEY'S GENERAL STORES CASY ⁽⁸⁾	551.2*	-4	1469.9	0	12.2	-4	18.8	4	2.2	2.2	8.2	18	0.64
CVS CVS	5876.5	9	17836.7	9	164.4	33	516.5	-5	2.8	2.3	7.7	30	0.92
DUANE READE DRD	312.8	12	943.4	12	8.0	26	23.3	44	2.6	2.3	10.4	14	1.38
FLEMING FLM	3972.6	12	11425.6	17	-1.5	NM	34.3	NM	NM	0.5	5.8	8	0.82
FOODARAMA FSM ⁽²⁾	241.5	4	728.8	5	1.2	15	2.7	-16	0.5	0.4	9.3	9	3.10
GREAT ATLANTIC & PACIFIC TEA GAP ⁽¹⁰⁾	2500.5	-2	8319.8	-2	-144.7	NM	-114.5	NM	NM	NM	-37.8	NM	-5.33
KROGER KR ⁽¹¹⁾	11927.0	4	39722.4	1	273.0	7	1004.6	8	2.3	2.2	30.5	11	1.40
LONGS DRUG STORES LDG ⁽¹¹⁾	1101.6	6	3404.8	7	10.9	-3	43.7	42	1.0	1.1	6.5	18	1.22
PATHMARK STORES PTMK ⁽¹¹⁾	987.2	-1	2966.5	-2	3.4	NM	-49.1	NM	0.3	NM	-31.3	NM	-3.67
PENN TRAFFIC PNFT ⁽¹¹⁾	598.0	-2	1789.1	-3	2.7	NM	-17.0	NM	0.5	NM	-31.6	NM	-2.23
PERFORMANCE FOOD GROUP PFGC	1169.8	46	3234.8	40	16.0	42	49.0	80	1.4	1.4	9.0	28	1.35
RITE AID RAD ⁽¹⁰⁾	3856.3	4	11819.3	3	-106.7	NM	-362.3	NM	NM	NM	NM	NM	-0.96
SAFEWAY SWY	8057.0	1	24070.6	2	281.3	-9	922.7	2	3.5	3.9	26.4	9	2.60
7-ELEVEN SE	2791.0**	6	7632.4	2	29.8	-29	62.9	-20	1.1	1.6	52.7	12	0.70
SPARTAN STORES SPTN ⁽⁹⁾	796.7*	-5	2327.1	-8	-0.5	NM	-12.7	NM	NM	1.1	-6.8	NM	-0.65
SUPERVALU SVU ⁽¹⁰⁾	4495.0	-5	14995.6	-12	58.8	16	168.7	NM	1.3	1.1	11.4	10	1.70
SYSCO SYY ⁽⁶⁾	6424.4	10	18355.3	8	182.6	11	539.9	13	2.8	2.8	31.8	30	1.06
UNITED NATURAL FOODS UNFI ⁽⁵⁾	309.3	15	895.1	16	4.1	-2	14.6	45	1.3	1.6	10.7	27	0.89
WALGREEN WAG ⁽⁴⁾	7235.3	15	22121.7	16	247.7	14	833.3	15	3.4	3.5	17.0	34	0.99
WEIS MARKETS WMK	495.9	1	1492.2	2	14.8	27	43.2	15	3.0	2.4	10.4	16	2.05
WINN-DIXIE STORES WIN ⁽⁶⁾	2832.8	1	8591.1	1	34.8	12	141.3	105	1.2	1.1	22.9	11	1.37

7 FOOD BEVERAGE & TOBACCO

INDUSTRY GROUP COMPOSITE	90499.1	7	262831.7	7	10584.6	46	26354.9	27	11.7	8.6	27.0	17	2.16
(A) BEVERAGES													
INDUSTRY COMPOSITE	25739.3	10	71626.4	9	3313.0	29	8765.2	21	12.9	11.0	30.7	26	1.71
ANHEUSER-BUSCH BUD	3706.2	7	10468.9	4	622.0	11	1664.6	13	16.8	16.2	50.1	25	2.14
BROWN-FORMAN BF.B ⁽⁸⁾	424.1	0	1388.1	2	36.1	-8	144.6	-3	8.5	9.3	17.3	22	3.29
COCA-COLA KO	5322.0	13	14769.0	11	1161.0	8	3252.0	6	21.8	22.9	35.9	28	1.68
COCA-COLA BOTTLING CONSOLIDATED COKE	333.0	29	957.4	29	9.5	21	23.7	113	2.9	3.1	51.6	21	2.48
COCA-COLA ENTERPRISES CCE	4549.0	7	12639.0	8	191.0	NM	416.0	NM	4.2	0.3	12.5	29	0.83
CONSTELLATION BRANDS STZ ⁽¹⁰⁾	689.8	0	2013.7	10	49.6	38	115.5	48	7.2	5.2	15.3	14	1.81
COORS (ADOLPH) RKY	1001.6	58	2795.2	49	46.6	20	141.4	32	4.7	6.1	14.5	16	4.32
PEPSI BOTTLING GROUP PBG	2455.0	8	6436.0	8	178.0	19	371.0	27	7.3	6.6	19.6	20	1.32
PEPSIAMERICAS PAS	882.5	4	2504.1	4	50.2	54	128.4	59	5.7	3.9	9.2	18	0.86
PEPSICO PEP	6376.0	7	17655.0	7	969.0	55	2508.0	26	15.2	10.5	33.3	25	1.76
(B) FOOD PRODUCTS													
INDUSTRY COMPOSITE	46828.3	10	135626.7	10	2614.5	26	7289.7	16	5.6	4.9	16.5	21	1.44
ARCHER DANIELS MIDLAND ADM ⁽⁶⁾	7510.6	36	19905.8	25	108.1	-18	337.5	20	1.4	2.4	7.2	18	0.75
BUNGE BG	3603.0	14	9390.0	13	95.0	67	181.0	138	2.6	1.8	15.9	10	2.49
CAMPBELL SOUP CPB ⁽⁵⁾	1223.0	5	4404.0	5	55.0	6	354.0	-20	4.5	4.5	NM	16	1.28
CHIKITA BRANDS INTERNATIONAL CQB	528.9	4	1790.3	6	-8.2	NM	-213.8	NM	NM	NM	-43.0	NM	-4.21
CONAGRA FOODS CAG ⁽⁷⁾	7063.2	-7	19721.4	-3	223.7	17	586.7	37	3.2	2.5	18.3	16	1.53
CORN PRODUCTS INTERNATIONAL CPO	480.1	1	1398.2	-1	17.1	-12	46.9	-1	3.6	4.1	7.0	19	1.57
DREYER'S GRAND ICE CREAM DRYR	383.6	6	1050.8	12	10.3	71	23.3	169	2.7	1.7	10.1	NM	0.62
FRESH DEL MONTE PRODUCE FDP	498.5	16	1603.1	6	32.5	292	166.1	83	6.5	1.9	23.5	9	3.05
GENERAL MILLS GIS ⁽⁷⁾	2362.0	68	7065.0	75	176.0	-8	316.0	-36	7.5	13.6	12.2	33	1.25
HEINZ (H.J.) HNZ ⁽⁸⁾	2203.6	6	7143.1	7	177.8	-11	603.0	101	8.1	9.7	47.2	14	2.29
HERSHEY FOODS HSY	1152.3	-2	2964.3	-1	123.1	2	273.3	8	10.7	10.2	16.7	39	1.65
HORMEL FOODS HRL ⁽²⁾	933.8	-4	2871.4	1	38.3	15	121.4	7	4.1	3.4	17.7	18	1.35
INTERSTATE BAKERIES IBC ⁽⁷⁾	839.2	2	2720.1	2	27.1	177	65.9	102	3.2	1.2	26.6	14	1.78
KELLOGG K	2136.5	-2	6323.4	12	203.5	35	529.9	48	9.5	6.9	59.8	20	1.59
KRAFT FOODS KFT	7216.0	3	21876.0	1	869.0	73	2463.0	85	12.0	7.2	11.9	23	1.74
McCORMICK MKC ⁽¹⁾	545.0	2	1616.5	3	35.2	3	102.6	17	6.5	6.4	27.6	19	1.15
PILGRIM'S PRIDE CHX ⁽³⁾	639.8	0	1877.7	3	-3.2	NM	1.3	-95	NM	2.2	3.6	18	0.35
SARA LEE SLE ⁽⁸⁾	4534.0	7	13229.0	8	308.0	27	916.0	-37	6.8	5.7	61.3	17	1.32
SMITHFIELD FOODS SFD ⁽⁸⁾	2000.7	22	6050.1	29	11.8	-79	91.3	-52	0.6	3.5	11.2	11	1.37
SMUCKER (J.M.) SJM ⁽⁸⁾	274.9	62	619.4	28	16.0	87	30.6	40	5.8	5.0	3.6	29	1.28

CORPORATE SCOREBOARD

COMPANY SYMBOL	SALES				PROFITS				MARGINS		RETURN ON COMMON EQUITY 12 MONTHS ENDING 9-30	PRICE-EARNINGS RATIO 10-31	12 MONTHS EARNINGS PER SHARE
	3RD QUARTER 2002 \$ MIL.	CHANGE FROM 2001 %	9 MONTHS 2002 \$ MIL.	CHANGE FROM 2001 %	3RD QUARTER 2002 \$ MIL.	CHANGE FROM 2001 %	9 MONTHS 2002 \$ MIL.	CHANGE FROM 2001 %	3RD QUARTER 2002 %	3RD QUARTER 2001 %			
WRIGLEY (WM.) JR. WWY	699.5	19	2007.0	14	98.5	8	293.8	8	14.1	15.5	27.2	31	1.70
(C) TOBACCO													
INDUSTRY COMPOSITE	17931.6	-3	55578.5	0	4657.0	79	10299.9	43	26.0	14.1	42.1	8	5.20
PHILIP MORRIS MO	15238.0	-4	47718.0	0	4359.0	87	9334.0	46	28.6	14.6	53.9	8	5.33
R.J. REYNOLDS TOBACCO HOLDINGS RJR	1585.0	-3	4805.0	0	139.0	9	517.0	46	8.8	7.9	8.1	6	6.57
UNIVERSAL UVV ⁽⁶⁾	657.3**	7	1796.7	-10	28.5	1	77.7	-12	4.3	4.6	18.2	9	4.05
UST UST	451.3	11	1258.8	3	130.5	5	371.2	5	28.9	30.5	68.5	10	2.99
8 HOUSEHOLD & PERSONAL PRODUCTS													
INDUSTRY GROUP COMPOSITE	23883.2	7	68711.4	5	2998.0	20	7579.6	39	12.6	11.2	37.8	25	2.19
(A) HOUSEHOLD PRODUCTS													
INDUSTRY COMPOSITE	18058.6	8	52169.4	5	2425.0	25	6113.9	49	13.4	11.6	38.0	24	2.85
CLOROX CLX ⁽⁶⁾	1047.0**	6	3216.0	6	158.0	42	349.0	29	15.1	11.3	29.6	26	1.76
COLGATE-PALMOLIVE CL	2381.7	3	6873.9	2	330.7	12	947.4	11	13.9	12.9	868.0	26	2.09
DIAL DL	347.2	5	988.0	5	31.1	124	88.1	98	9.0	4.2	110.9	18	1.21
KIMBERLY-CLARK KMB	3486.7	3	10226.5	3	441.2	5	1316.4	4	12.7	12.4	27.7	16	3.17
PROCTER & GAMBLE PG ⁽⁶⁾	10796.0	11	30865.0	7	1464.0	33	3413.0	104	13.6	11.3	34.2	26	3.35
(B) PERSONAL PRODUCTS													
INDUSTRY COMPOSITE	5824.6	4	16542.0	5	573.0	4	1465.7	9	9.8	9.9	36.7	29	1.12
ALBERTO-CULVER ACV ⁽³⁾	697.9	13	2036.7	12	39.3	24	108.4	25	5.6	5.2	16.0	22	2.32
AVON PRODUCTS AVP	1463.4	3	4374.2	3	90.3	-21	341.8	2	6.2	8.1	NM	26	1.88
ESTEE LAUDER EL ⁽⁶⁾	1242.5	4	3493.2	4	73.4	-24	98.7	-46	5.9	8.1	11.9	42	0.69
GILLETTE G	2168.0	2	5924.0	5	354.0	20	870.0	23	16.3	13.9	42.1	30	1.01
NU SKIN ENTERPRISES NUS	252.9	13	713.9	9	15.9	27	46.9	28	6.3	5.6	15.8	16	0.73
ENERGY SECTOR													
SECTOR COMPOSITE	128060.4	10	348795.4	-6	3199.4	-50	12003.5	-61	2.5	5.5	5.9	36	1.02
9 ENERGY													
INDUSTRY GROUP COMPOSITE	128060.4	10	348795.4	-6	3199.4	-50	12003.5	-61	2.5	5.5	5.9	36	1.02
(A) ENERGY EQUIPMENT & SERVICES													
INDUSTRY COMPOSITE	9085.0	-11	26798.9	-6	509.0	-32	1528.6	-12	5.6	7.3	6.8	29	1.05
BAKER HUGHES BHI	1288.1	-7	3762.7	-3	87.5	-36	234.7	-25	6.8	9.9	10.5	27	1.07
COOPER CAMERON CAM	383.8**	-8	1153.3	0	20.7	-40	62.8	-8	5.4	8.2	9.1	28	1.64
FMC TECHNOLOGIES FTI	525.4	11	1491.3	8	16.8	47	39.6	120	3.2	2.4	21.7	20	0.92
NABORS INDUSTRIES NBR	347.0	-43	1069.0	-39	26.9	-75	94.3	-68	7.8	17.6	6.8	36	0.98
NATIONAL-OILWELL NOI	366.9	-25	1128.3	-12	17.8	-39	55.9	-26	4.8	5.9	9.3	20	1.03
PRIDE INTERNATIONAL PDE	285.7	-30	852.0	-26	-5.5	NM	-9.1	NM	NM	1.2	-0.4	NM	-0.05
SCHLUMBERGER SLB	3501.4	-7	10199.3	-3	172.8	-11	541.3	61	4.9	5.2	8.3	32	1.26
SMITH INTERNATIONAL SII	777.2	-15	2405.6	-9	19.8	-53	75.4	-34	2.5	4.6	10.9	27	1.15
TRANSOCEAN RIG	695.2	-10	2009.3	-3	255.2	161	412.5	93	36.7	12.7	4.9	15	1.42
VARCO INTERNATIONAL VRC	329.4	1	981.0	8	18.7	-25	58.7	5	5.7	7.6	9.6	19	0.88
WEATHERFORD INTERNATIONAL WFT	584.9	-4	1747.0	2	-121.6	NM	-37.6	NM	NM	9.9	0.8	NM	0.13
(B) OIL & GAS													
INDUSTRY COMPOSITE	118975.4	12	321996.5	-6	2690.4	-52	10474.9	-63	2.3	5.3	5.8	37	1.02
AMERADA HESS AHC	2818.0	-2	8635.0	-18	-136.0	NM	153.0	-82	NM	5.8	4.4	22	2.33
ANADARKO PETROLEUM APC	951.0	-6	2743.0	-30	190.0	NM	520.0	NM	20.0	NM	9.5	18	2.42
APACHE APA	655.9	-2	1837.6	-19	146.5	-7	373.5	-42	22.3	23.5	9.5	17	3.09
ASHLAND ASH ⁽³⁾ †	2104.0	-2	5780.0	-2	47.0	-61	91.0	-74	2.2	5.7	5.9	14	1.83
BURLINGTON RESOURCES BR	630.0	-5	2082.0	-24	79.0	8	297.0	-53	12.5	11.0	5.7	38	1.08
CHEVRONTXACO CVX	23746.0	0	66374.0	-15	-904.0	NM	228.0	-96	NM	7.4	-6.7	NM	-2.02
CONOCOPHILLIPS COP	13736.0	153	32158.0	115	-54.0	NM	212.0	-86	NM	6.8	1.3	53	0.92
EOG RESOURCES EOG	278.3	-21	756.0	-47	28.9	-60	42.8	-90	10.4	20.3	0.5	NM	0.05
EXXON MOBIL XOM	48339.0	3	132398.0	-12	2640.0	-17	7370.0	-42	5.5	6.8	13.4	23	1.47
FRONTIER OIL FTO	486.7	-10	1282.2	-16	0.8	-98	-1.9	NM	0.2	6.4	-7.4	NM	-0.49
HOLLY HOC ⁽⁵⁾	253.9	-4	631.0	-23	6.1	-69	11.8	-78	2.4	7.4	14.0	9	2.01
KERR-McGEE KMG	984.4	14	2714.9	-4	-86.8	NM	-266.2	NM	NM	2.0	-10.3	NM	-3.15
MARATHON OIL MRO	8435.0	-1	22931.0	-13	94.0	-49	342.0	-73	1.1	2.2	7.7	16	1.27
MURPHY OIL MUR	1153.8	1	3118.4	-14	37.4	-10	53.9	-82	3.2	3.7	5.3	47	1.80
NOBLE ENERGY NBL	336.4	11	985.4	-23	-1.2	NM	0.8	-99	NM	1.3	-2.7	NM	-0.47
OCCIDENTAL PETROLEUM OXY	1963.0	-1	5353.0	-20	476.0	7	840.0	-41	24.2	22.3	10.2	18	1.57
OCEAN ENERGY OEI	314.4	13	822.7	-21	6.8	-86	75.8	-70	2.2	17.1	6.3	35	0.54
SUNOCO SUN	3311.0	6	8868.0	-10	-9.0	NM	-105.0	NM	NM	2.9	-6.6	NM	-1.34
UNOCAL UCL	1287.0**	-18	3660.0	-33	99.0	-3	234.0	-63	7.7	6.5	6.4	33	0.83
VALERO ENERGY VLO	7191.7	86	18866.5	56	29.8	-71	2.5	NM	0.4	2.6	1.3	42	0.84

COMPANY SYMBOL	SALES				PROFITS				MARGINS		RETURN ON COMMON EQUITY 12 MONTHS ENDING 9-30	PRICE-EARNINGS RATIO 10-31	12 MONTHS' EARNINGS PER SHARE	
	3RD QUARTER 2002 \$ MIL.	CHANGE FROM 2001 %	9 MONTHS 2002 \$ MIL.	CHANGE FROM 2001 %	3RD QUARTER 2002 \$ MIL.	CHANGE FROM 2001 %	9 MONTHS 2002 \$ MIL.	CHANGE FROM 2001 %	3RD QUARTER 2002 %	3RD QUARTER 2001 %				
FINANCIAL SECTOR														
SECTOR COMPOSITE	247859.8	-2	738192.9	-5	28284.9	46	84452.1	18	11.4	7.7	13.2	16	2.32	
10 BANKS														
INDUSTRY GROUP COMPOSITE	70545.7	-6	212072.1	-8	12897.4	48	38470.0	37	18.3	11.6	15.3	14	2.58	
AMSOUTH BANCORPORATION ASO	758.3**	-10	2273.1	-12	156.0	15	453.9	15	20.6	16.2	19.0	12	1.64	
ASSOCIATED BANC-CORP ASBC	258.4	-3	751.9	-8	53.5	19	157.3	18	20.7	17.0	16.0	12	2.72	
ASTORIA FINANCIAL AF	350.4**	-9	1064.0	-9	62.2	10	187.4	10	17.8	14.6	14.9	10	2.74	
BANK OF AMERICA 8AC	11405.0	-11	34181.0	-15	2235.0	166	6635.0	40	19.6	6.6	18.2	13	5.50	
BANK OF NEW YORK BK	1285.0**	-27	4295.0	-21	79.0	-67	802.0	-21	6.1	13.9	17.1	17	1.55	
BANK ONE ONE	5518.0	-9	16653.0	-11	823.0	9	2453.0	15	14.9	12.5	13.7	15	2.54	
BANKNORTH GROUP 8KNG	378.7	3	1118.6	-1	76.9	24	221.5	25	20.3	17.0	14.8	12	1.91	
BB&T BBT	1549.2	0	4531.9	-4	328.2	48	956.0	37	21.2	14.3	16.4	14	2.61	
BOK FINANCIAL 8OKF	252.4	6	676.7	-5	44.1	48	111.6	30	17.5	12.5	15.1	14	2.35	
CHARTER ONE FINANCIAL CF	707.8	-3	2110.1	0	143.6	10	431.9	18	20.3	17.9	18.6	13	2.38	
COMERICA CMA	898.0	-12	2769.0	-14	24.0	-89	395.0	-23	2.7	20.4	12.4	13	3.33	
COMMERCE BANCORP C8H	266.4**	30	740.6	26	37.7	43	104.2	39	14.1	12.8	15.2	24	1.88	
FIFTH THIRO BANCORP FIT8	1644.2	1	4712.4	-5	416.7	49	1211.2	69	25.3	17.3	19.5	24	2.69	
FIRST TENNESSEE NATIONAL FTN	652.5	11	1820.7	0	95.6	7	273.1	14	14.6	15.1	23.2	13	2.78	
FLEETBOSTON FINANCIAL F8F	3726.0	-22	11501.0	-21	597.0	-23	1226.0	-15	16.0	16.1	4.2	34	0.69	
GOLDEN STATE BANCORP GS8	856.3**	-20	2569.9	-23	128.0	24	332.5	10	15.0	9.6	15.6	12	3.06	
GOLDEN WEST FINANCIAL GDW	946.3**	-13	2789.6	-19	244.5	19	708.9	20	25.8	19.0	19.5	12	5.95	
GREENPOINT FINANCIAL GPT	439.0**	-5	1310.0	3	127.0	12	370.0	26	28.9	24.4	25.4	8	5.36	
HIBERNIA HIB	341.8	-6	1004.3	-11	63.2	10	184.9	14	18.5	15.7	14.6	13	1.51	
KEYCORP KEY	1527.0	-17	4612.0	-19	245.0	-2	731.0	121	16.0	13.6	8.4	19	1.29	
M&T BANK MTB	589.6	-8	1757.6	-10	117.2	20	359.3	30	19.9	15.2	15.1	17	4.80	
MARSHALL & ILSLEY MI	665.3	-2	1959.0	-5	119.2	43	355.2	55	17.9	12.3	17.0	13	2.10	
MELLON FINANCIAL MEL	1152.0**	2	3562.0	9	186.0	4	503.0	5	16.1	15.9	13.8	27	1.05	
NATIONAL CITY NCC	2063.7	-8	6521.0	-6	374.2	5	1213.1	16	18.1	16.0	19.6	11	2.54	
NATIONAL COMMERCE FINANCIAL NCF	394.4	1	1157.0	-3	83.0	44	238.7	44	21.0	14.8	11.3	17	1.44	
NORTH FORK BANCORPORATION NFB	336.8**	10	974.1	7	106.8	26	309.6	28	31.7	27.7	24.2	16	2.47	
NORTHERN TRUST NTRS	678.6**	-15	2112.1	-17	96.4	-24	350.8	-9	14.2	15.9	16.0	17	1.99	
PNC FINANCIAL SERVICES GROUP PNC	1527.0	-10	4818.0	-6	285.0	15	922.0	14	18.7	14.5	7.3	24	1.71	
POPULAR BPOP	625.6	-2	1892.8	-3	85.8	11	271.1	19	13.7	12.1	14.8	13	2.54	
REGIONS FINANCIAL RF	967.4	-5	2817.0	-7	156.5	16	463.7	25	16.2	13.3	14.7	13	2.63	
SOUTHTRUST SOTR	831.1	-10	2498.6	-12	164.2	16	483.0	18	19.8	15.4	13.7	14	1.80	
SOVEREIGN BANCORP SOV	634.5**	-4	1858.9	-8	93.1	981	248.9	399	14.7	1.3	12.0	12	1.21	
SUNTRUST BANKS STI	1851.6	-10	5682.2	-12	343.0	3	991.6	-4	18.5	16.2	15.0	13	4.62	
SYNOVUS FINANCIAL SNV	580.7	3	1686.2	-2	92.3	17	260.9	15	15.9	14.0	17.7	18	1.17	
TCF FINANCIAL TC8	287.6**	-4	861.0	-5	58.9	11	173.2	13	20.5	17.6	23.9	14	3.05	
U.S. BANCORP USB	3978.3	-1	11480.7	-9	860.3	NM	2476.6	145	21.6	1.0	18.1	13	1.65	
UNION PLANTERS UPC	667.4	-14	1991.6	-17	134.2	20	387.7	18	20.1	14.4	15.6	12	2.43	
UNIONBANCAL U8	645.5	-9	1931.3	-13	138.2	10	383.0	10	21.4	17.6	14.2	13	3.26	
WACHOVIA WB	5802.0**	17	17736.0	11	916.0	NM	2684.0	204	15.8	NM	11.2	14	2.48	
WASHINGTON MUTUAL WM	4695.0**	6	13984.0	1	976.0	17	2911.0	28	20.8	18.8	17.1	10	3.63	
WELLS FARGO WFC	7044.0	-1	21030.0	6	1444.0	24	4244.0	89	20.5	16.4	18.1	16	3.14	
WESTCORP WES	325.4**	24	905.5	18	21.7	164	60.2	41	6.7	3.1	12.5	10	1.91	
ZIONS BANCORPORATION ZION	441.4	-13	1370.5	-10	65.4	-15	233.0	4	14.8	15.2	12.7	12	3.24	
11 DIVERSIFIED FINANCIALS														
INDUSTRY GROUP COMPOSITE	110232.7	-6	332087.9	-10	10072.3	2	29388.7	-11	9.1	8.4	13.2	15	2.26	
AMERICAN EXPRESS AXP	5907.0**	3	17611.0	5	687.0	131	1988.0	96	11.6	5.2	17.2	21	1.71	
AMERICREIT ACF (6)	335.8	21	961.5	30	70.2	-11	258.4	23	20.9	28.3	22.6	2	3.80	
BEAR STEARNS BSC (1)	1581.4	-31	5369.9	-22	164.4	22	687.8	46	10.4	5.8	15.3	10	6.18	
CAPITAL ONE FINANCIAL COF	2628.3	38	7213.6	34	258.8	57	660.0	42	9.8	8.7	19.3	8	3.68	
CIT GROUP CIT (3)	1224.2**	-18	3831.0	-16	134.7	-26	-6214.2	NM	11.0	12.1	NM	NA	NA	
CITIGROUP C	23505.0**	-4	69760.0	-8	3706.0	15	11019.0	14	15.8	13.2	20.7	13	2.79	
COUNTRYWIDE CREDIT INDUSTRIES CCR	2377.4	NA	6030.0	NA	228.5	NA	586.9	NA	9.6	NA	NA	NA	NA	
E*TRADE GROUP ET	471.4	-3	1426.9	-9	20.7	NM	73.7	NM	4.4	NM	5.6	20	0.22	
EDWARDS (A.G.) AGE (10)	570.0	-6	1752.0	-7	26.6	-35	28.7	-78	4.7	6.8	3.1	51	0.64	
FANNIE MAE FNM	13319.1	3	39518.0	4	994.3	-19	3666.6	-2	7.5	9.5	42.0	12	5.51	
FRANKLIN RESOURCES 8EN (3)	608.3**	1	1900.3	6	68.5	-18	314.2	-6	11.3	13.9	10.1	20	1.65	
FREDDIE MAC FRE	9650.0	7	28717.0	9	1378.0	34	3901.0	40	14.3	11.5	29.0	8	7.40	
GOLDMAN SACHS GROUP GS (1)	5872.0	-20	17806.0	-29	522.0	12	1609.0	-11	8.9	6.4	11.2	18	3.97	
HOUSEHOLD INTERNATIONAL HI	3859.1	11	11174.3	10	221.2	-54	1219.6	-7	5.7	14.0	20.2	6	3.69	
INSTINET GROUP INET	254.3**	-20	792.1	-31	-528.4	NM	-581.8	NM	NM	4.9	-38.8	NM	-2.13	
J.P. MORGAN CHASE JPM	10527.0**	-16	32674.0	-19	40.0	-91	2050.0	0	0.4	3.6	3.9	26	0.81	
LEGG MASON LM (9)	395.5	6	1233.7	9	45.4	49	140.5	36	11.5	8.1	16.0	18	2.64	
LEHMAN BROTHERS HOLDINGS LEH (1)	4075.0	-19	12648.0	-30	194.0	-37	788.0	-30	4.8	6.1	10.4	16	3.23	
MBNA KR8	2819.2	5	7860.5	6	398.0	-17	1225.8	5	14.1	17.9	21.1	15	1.33	
MERRILL LYNCH MER	6860.0	-23	21775.0	-30	693.0	64	1974.0	7	10.1	4.7	3.2	68	0.56	

CORPORATE SCOREBOARD

COMPANY SYMBOL	SALES				PROFITS				MARGINS		RETURN ON COMMON EQUITY 12 MONTHS ENDING 9-30	PRICE-EARNINGS RATIO 10-31	12 MONTHS EARNING PER SHARE
	3RD QUARTER 2002 \$ MIL.	CHANGE FROM 2001 %	9 MONTHS 2002 \$ MIL.	CHANGE FROM 2001 %	3RD QUARTER 2002 \$ MIL.	CHANGE FROM 2001 %	9 MONTHS 2002 \$ MIL.	CHANGE FROM 2001 %	3RD QUARTER 2002 %	3RD QUARTER 2001 %			
METRIS MXT	335.0	-28	1111.4	-15	-1.3	NM	14.6	-92	NM	15.3	7.0	6	0.50
MOODY'S MCO	248.3	30	751.4	30	67.8	36	219.1	43	27.3	26.2	NM	27	1.76
MORGAN STANLEY MWD ⁽¹⁾	8056.0	-22	24672.0	-31	611.0	-17	2256.0	-18	7.6	7.1	14.6	14	2.81
PROVIOIAN FINANCIAL PVN	853.6	-43	3413.5	-27	42.1	-28	138.9	-74	4.9	3.9	-12.0	NM	-0.90
RAYMOND JAMES FINANCIAL RJF ⁽³⁾	382.7	0	1151.8	-8	22.0	74	61.2	-5	5.7	3.3	9.4	20	1.60
SCHWAB (CHARLES) SCH	1031.0**	1	3139.0	-5	-4.0	NM	176.0	93	NM	1.3	3.8	77	0.12
SLM SLM	769.9	-20	2518.8	-20	-62.4	NM	486.0	312	NM	NM	44.6	22	4.70
STATE STREET STT	1208.0	-15	3698.0	-16	182.0	7	538.0	17	15.1	12.0	16.3	19	2.16
STILWELL FINANCIAL SV †	257.8	-29	896.5	-27	-131.2	NM	39.7	-83	NM	7.4	7.3	27	0.44
WFS FINANCIAL WFSI	250.5	52	680.5	37	23.3	150	64.1	34	9.3	5.7	12.7	9	2.02

12 INSURANCE

INDUSTRY GROUP COMPOSITE	63636.7	12	183857.2	10	4926.9	NM	15229.1	63	7.7	0.7	10.1	20	2.11
AFLAC AFL	2707.0	11	7591.0	6	240.0	24	635.0	21	8.9	7.9	13.7	20	1.51
ALLSTATE ALL	7239.0	1	21992.0	2	280.0	24	1050.0	16	3.9	3.2	7.6	22	1.84
AMERICAN INTERNATIONAL GROUP AIG	15309.2**	11	44727.2	11	1841.2	351	5622.7	55	12.0	3.0	13.6	22	2.83
AMERICAN NATIONAL INSURANCE ANAT	582.3	7	1725.1	9	31.4	NM	79.7	8	5.4	NM	2.9	29	2.68
AON AOC	2246.0	17	6456.0	14	128.0	78	288.0	140	5.7	3.8	8.5	16	1.12
BERKLEY (W.R.) 8ER	634.1	27	1747.9	21	40.5	NM	102.3	NM	6.4	NM	3.4	62	0.60
CINCINNATI FINANCIAL CINF	731.0	14	2121.0	11	72.0	100	182.0	16	9.9	5.6	3.9	29	1.33
EVEREST RE GROUP RE	623.0	47	1751.3	33	61.3	NM	175.7	176	9.8	NM	9.2	14	4.20
FIDELITY NATIONAL FINANCIAL FNF	1282.8	28	3492.7	27	143.5	71	356.8	63	11.2	8.4	21.3	7	4.56
FIRST AMERICAN FAF	1197.1**	22	3332.5	24	67.4	62	151.6	32	5.6	4.2	16.7	8	2.60
FUNO AMERICAN ENTERPRISES HOLOINGS WTM	1063.1	-21	3155.6	54	54.6	NM	35.9	NM	5.1	NM	-4.7	NM	-13.27
GALLAGHER (ARTHUR J.) AJG	297.0	29	808.1	24	23.3	-44	91.4	-1	7.8	18.2	25.5	20	1.36
HARTFORD FINANCIAL SERVICES GROUP HIG	3961.0	6	11746.0	4	265.0	NM	742.0	87	6.7	NM	9.3	11	3.54
JEFFERSON-PILOT JP	880.7	4	2643.5	4	118.8	-11	383.6	-8	13.5	15.8	13.5	13	3.20
JOHN HANCOCK FINANCIAL SERVICES JHF	2170.0	3	6634.0	-1	158.1	-4	402.9	-21	7.3	7.8	8.5	17	1.70
LANOAMERICA FINANCIAL GROUP LFG	628.6	16	1809.7	18	39.9	113	83.0	54	6.3	3.5	11.2	7	4.79
LINCOLN NATIONAL LNC	1141.0	-29	3412.4	-30	-125.5	NM	28.4	-93	NM	7.4	3.7	30	1.03
MARKEL MKL	486.1	29	1261.0	25	8.7	NM	49.0	NM	1.8	NM	0.5	NM	0.19
MARSH & MCLENNAN MMC	2553.0	6	7800.0	3	299.0	78	1053.0	27	11.7	7.0	23.8	22	2.14
MGIC INVESTMENT MTG	390.8**	15	1150.2	15	151.6	-5	491.7	3	38.8	46.8	19.6	7	6.16
NATIONWIDE FINANCIAL SERVICES NFS	802.1**	5	2384.1	3	-141.0	NM	43.1	-88	NM	17.2	2.8	35	0.80
OHIO CASUALTY OCAS	403.2	-19	1262.8	-11	-69.9	NM	-30.0	NM	NM	8.9	1.1	66	0.20
OLD REPUBLIC INTERNATIONAL ORI	701.0	17	1998.1	15	96.3	17	299.4	16	13.7	13.7	13.1	9	3.20
PMI GROUP PMI	288.6**	22	828.0	26	89.3	13	254.7	13	31.0	33.5	16.0	8	3.68
PROGRESSIVE PGR	2415.8**	30	6737.9	23	178.5	85	515.1	80	7.4	5.2	18.1	19	2.85
RAOIAN GROUP RDN †	263.8	14	787.6	21	106.6	16	319.4	21	40.4	39.4	15.4	8	4.27
REINSURANCE GROUP OF AMERICA RGA	550.2	20	1667.7	18	34.7	286	92.7	52	6.3	2.0	6.6	19	1.44
SAFECO SAFC	1794.6	5	5305.5	3	75.2	NM	244.0	NM	4.2	NM	6.8	18	1.97
ST. PAUL SPC	2288.1	3	6906.4	6	68.6	NM	-1.3	NM	3.0	NM	-14.8	NM	-3.55
STANCORP FINANCIAL GROUP SFG	428.3	7	1282.0	9	27.6	7	77.1	-1	6.4	6.5	9.3	15	3.51
STATE AUTO FINANCIAL STFC	247.0	58	713.1	79	5.9	-19	17.7	-43	2.4	4.6	1.7	94	0.17
STEWART INFORMATION SERVICES STC	473.4**	39	1228.5	36	21.6	66	50.7	61	4.6	3.8	15.1	5	3.80
TRANSATLANTIC HOLDINGS TRH	702.7	30	1935.4	26	61.3	NM	175.7	NM	8.7	NM	8.9	18	3.44
TRAVELERS PROPERTY CASUALTY TAP.8	3563.9	18	10116.4	12	332.3	NM	1009.0	33	9.3	NM	12.8	9	1.48
21ST CENTURY INSURANCE GROUP TW	249.4**	9	711.7	4	-45.2	NM	-27.1	NM	NM	1.2	-10.4	NM	-0.80
XL CAPITAL XL	2341.8	176	4634.8	95	186.4	NM	184.2	NM	8.0	NM	1.7	NM	0.68

13 REAL ESTATE

INDUSTRY GROUP COMPOSITE	3444.7	9	10175.6	12	388.3	-4	1364.4	27	11.3	12.8	8.4	27	0.86
BOSTON PROPERTIES BXP	310.6	12	880.6	15	59.8	14	168.9	8	19.2	19.0	11.2	15	2.33
EQUITY OFFICE PROPERTIES TRUST EOP	893.7	-1	2732.2	21	175.2	-17	565.3	19	19.6	23.6	6.2	15	1.56
FOREST CITY ENTERPRISES FCE.A ⁽¹¹⁾	239.9**	4	706.8	9	12.7	-18	35.8	22	5.3	6.7	14.9	15	2.11
HOTEL MARRIOTT HMT	789.0	-7	2499.0	-8	-38.0	NM	-26.0	NM	NM	NM	-6.5	NM	-2.73
PLUM CREEK TIMBER PCL	310.0	120	856.0	139	70.0	46	179.0	60	22.6	34.0	18.1	10	2.22
ROUSE RSE †	327.8**	30	871.7	10	32.3	10	145.2	67	9.9	11.6	11.6	16	1.87
SIMON PROPERTY GROUP SPG	573.7	12	1629.4	7	76.4	44	296.3	111	13.3	10.3	11.0	21	1.66

HEALTH CARE SECTOR

SECTOR COMPOSITE	148951.6	10	437439.3	9	11084.1	-5	38645.9	14	7.4	8.6	21.7	25	1.62
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14 HEALTH CARE EQUIPMENT & SERVICES

INDUSTRY GROUP COMPOSITE	96295.0	11	283656.7	10	3256.1	16	11501.9	39	3.4	3.2	15.8	24	1.54
(A) HEALTH CARE EQUIPMENT & SUPPLIES													
INDUSTRY COMPOSITE	9762.4	15	28499.3	13	1504.9	34	3977.4	39	15.4	13.2	18.5	32	1.15
APPLIED BIOSYSTEMS GROUP ABI ⁽⁶⁾	395.9	8	1222.2	1	34.2	6	121.5	-12	8.6	8.8	15.2	25	0.80
BARO (C.R.) 8CR	322.7	8	942.1	7	29.8	-17	108.4	4	9.2	12.0	17.9	20	2.79
BAUSCH & LOMB BOL	466.7	11	1339.3	9	9.4	-60	40.1	39	2.0	5.6	5.3	32	0.97
BAXTER INTERNATIONAL BAX	2102.0	11	6074.0	10	316.0	16	769.0	4	15.0	14.3	17.0	23	1.11

COMPANY SYMBOL	SALES				PROFITS				MARGINS		RETURN ON COMMON EQUITY 12 MONTHS ENDING 9-30	PRICE- EARNINGS RATIO 10-31	12 MONTHS' EARNINGS PER SHARE
	3RD QUARTER 2002 \$ MIL.	CHANGE FROM 2001 %	9 MONTHS 2002 \$ MIL.	CHANGE FROM 2001 %	3RD QUARTER 2002 \$ MIL.	CHANGE FROM 2001 %	9 MONTHS 2002 \$ MIL.	CHANGE FROM 2001 %	3RD QUARTER 2002 %	3RD QUARTER 2001 %			
BECKMAN COULTER BEC	501.1	5	1463.9	4	32.1	3	102.0	9	6.4	6.9	23.5	12	2.31
BIOMET BMET ⁽⁷⁾	317.6	17	948.1	15	66.0	18	188.3	23	20.8	20.6	22.1	31	0.94
BOSTON SCIENTIFIC BSX	722.0	8	2105.0	5	161.0	178	268.0	NM	22.3	8.7	14.6	46	0.81
COVENTRY HEALTH CARE CVH	363.5	43	1092.7	45	35.8	38	105.7	21	9.8	10.2	18.5	21	1.76
COVARIANT GDT	827.4	25	2344.1	18	175.1	43	519.4	49	21.2	18.5	29.8	14	2.13
CVACARE IVC	280.3	3	807.2	2	19.2	-1	47.1	0	6.8	7.1	7.8	28	1.13
DETRONIC MDT ⁽⁸⁾	1713.9	18	5097.8	18	383.3	27	999.1	32	22.4	20.7	15.8	51	0.87
ST. JUDE MEDICAL STJ	404.9	20	1180.4	18	71.7	128	203.3	66	17.7	9.3	17.2	26	1.39
STRYKER SYK	745.6	20	2182.4	15	72.5	20	239.5	26	9.7	9.8	23.3	40	1.58
VARIAN MEDICAL SYSTEMS VAR ⁽³⁾	261.4	16	698.0	14	33.8	46	80.4	38	12.9	10.2	19.8	36	1.33
ZIMMER HOLDINGS ZMH	337.5	18	1002.2	16	65.1	138	185.6	74	19.3	9.6	79.9	35	1.17
(B) HEALTH CARE PROVIDERS & SERVICES													
INDUSTRY COMPOSITE	86532.7	10	255157.4	10	1751.2	4	7524.5	39	2.0	2.1	14.7	20	1.85
ADVANCEPCS ADVP ⁽⁹⁾	3852.7	22	10883.8	17	42.2	48	114.0	101	1.1	0.9	16.4	17	1.46
AETNA AET	4832.1**	22	15161.0	21	98.8	NM	295.0	NM	2.0	NM	1.3	73	0.55
AMERIGROUP AMGP	299.1	25	850.8	33	12.5	30	35.3	32	4.2	4.0	19.6	14	2.13
APRIA HEALTHCARE GROUP AHG	312.0	10	923.8	10	26.5	38	75.6	41	8.5	6.7	30.7	14	1.72
CARDINAL HEALTH CAH ⁽⁶⁾	13086.1	11	39356.3	7	288.3	17	884.9	28	2.2	2.1	18.4	27	2.56
CAREMARK RX CMX	1713.4	24	4954.0	20	82.0	67	217.0	67	4.8	3.6	NM	17	1.05
CIGNA CI	5218.0	9	15016.0	6	877.0	NM	445.0	NM	NM	5.7	3.4	20	1.84
COBALT CBZ	385.7	-7	1143.0	7	13.9	NM	49.9	NM	3.6	0.2	10.3	24	0.68
COMMUNITY HEALTH SYSTEMS CYH	552.8	33	1616.9	33	25.4	153	76.8	152	4.6	2.4	8.0	25	0.95
COVENTRY HEALTH CARE CVH	892.0	12	2630.6	13	40.2	86	105.2	73	4.5	2.7	20.0	16	2.05
D&K HEALTHCARE RESOURCES DKWD ⁽⁸⁾	534.0	1	1866.9	27	2.9	20	15.7	67	0.5	0.7	12.3	7	1.36
EXPRESS SCRIPTS ESRX	3426.2	44	9577.9	43	53.9	66	146.6	61	1.6	1.4	18.6	24	2.27
HCA HCA	4929.0	11	14705.0	10	200.0	-22	935.0	11	4.1	5.8	17.3	23	1.89
HEALTH MANAGEMENT ASSOCIATES HMA ⁽³⁾	594.4	21	1766.8	22	60.1	16	196.0	27	10.1	10.6	18.3	20	0.97
HEALTH NET HNT	2559.4	1	7500.6	0	69.0	NM	192.5	530	2.7	0.1	18.5	12	1.98
HUMANA HUM	2841.6**	9	8406.1	11	52.3	73	144.5	76	1.8	1.2	10.8	11	1.07
IMS HEALTH RX	361.8	10	1046.2	5	82.3	99	203.4	18	22.7	12.6	106.3	25	0.59
KINDRED HEALTHCARE KIND	859.7	12	2509.5	9	-11.6	NM	30.3	-62	NM	1.9	7.4	6	2.33
LABORATORY CORP. OF AMERICA HOLDINGS LH	655.2	17	1857.6	14	57.3	24	201.6	42	8.7	8.3	15.4	14	1.70
LINCARE HOLDINGS LNCR	244.2	18	707.2	18	48.5	39	140.1	38	19.8	16.8	20.7	22	1.57
MANOR CARE HCR	732.9	7	2177.3	9	37.1	19	108.8	26	5.1	4.5	8.8	22	0.91
McKESSON MCK ⁽⁹⁾	13690.3	13	40304.7	14	128.4	61	371.6	NM	0.9	0.7	11.4	18	1.62
OWENS & MINOR OMI	992.5	3	2938.7	3	10.7	533	33.0	75	1.1	0.2	16.8	12	1.19
OXFORD HEALTH PLANS OHP	1274.4**	15	3664.8	11	23.8	-72	148.1	35	1.9	7.7	43.3	14	2.61
PACIFICARE HEALTH SYSTEMS PHSY	2779.7	-6	8412.6	6	43.8	171	102.2	129	1.6	0.5	5.9	14	2.14
PATTERSON DENTAL PDCO ⁽⁸⁾	387.7	28	1145.0	27	25.1	28	77.5	27	6.5	6.5	18.5	35	1.47
PRIORITY HEALTHCARE PHCC	306.0	46	863.5	49	11.7	52	32.0	35	3.8	3.7	14.2	27	0.91
QUEST DIAGNOSTICS DGX	1058.7	17	3074.3	13	86.6	73	240.4	81	8.2	5.5	17.4	22	2.93
QUINTILES TRANSNATIONAL QTRN	393.5	3	1170.8	4	21.2	NM	59.1	NM	5.4	NM	8.8	10	1.10
SELECT MEDICAL SEM	279.0	17	831.2	19	9.4	47	32.1	60	3.4	2.7	18.5	13	1.02
SIERRA HEALTH SERVICES SIE	381.3**	15	1093.9	15	12.1	165	30.0	154	3.2	1.4	23.2	11	1.16
TENET HEALTHCARE THC ⁽⁷⁾	3703.0	12	10925.0	14	338.0	118	947.0	88	9.1	4.7	19.4	13	2.27
TRIAO HOSPITALS TRI	894.0	8	2622.1	43	32.6	402	105.8	NM	3.6	0.8	6.1	23	1.61
UNITEDHEALTH GROUP UNH	6247.0**	5	18338.0	5	353.0	53	973.0	46	5.7	3.9	28.0	24	3.81
UNIVERSAL HEALTH SERVICES UHS	813.1**	13	2423.4	15	41.5	37	131.5	33	5.1	4.2	14.1	23	2.07
WELLPOINT HEALTH NETWORKS WLP	4450.2**	37	12692.3	41	208.9	93	518.0	70	4.7	3.3	16.6	18	4.27
15 PHARMACEUTICALS & BIOTECHNOLOGY													
INDUSTRY GROUP COMPOSITE	52656.6	9	153782.5	8	7827.9	-11	27143.9	6	14.9	18.2	25.6	25	1.64
(A) BIOTECHNOLOGY													
INDUSTRY COMPOSITE	3050.9	31	8088.2	22	-2332.7	NM	-1470.4	NM	NM	18.0	-3.8	NM	-0.40
AMGEN AMGN	1499.3	49	3756.9	30	2601.6	NM	-1848.3	NM	NM	32.9	-9.5	NM	-1.34
BIOMGEN BGEN	288.3	9	845.9	11	42.2	40	157.7	-26	14.6	26.4	14.0	26	1.42
CHIRON CHIR	336.1	20	841.4	10	83.9	63	115.4	11	25.0	18.3	7.9	48	0.83
GENENTECH DNA	654.3**	25	1861.8	23	89.3	109	29.0	NM	13.6	8.2	0.2	NM	0.02
GENZYME GENERAL GENZ	272.8	7	782.1	9	53.4	NM	133.8	NM	19.6	NM	7.2	34	0.82
(B) PHARMACEUTICALS													
INDUSTRY COMPOSITE	49605.7	7	145694.3	8	10160.7	21	28614.3	18	20.5	18.2	33.6	22	1.87
ABBOTT LABORATORIES ABT	4341.2	4	12845.4	8	720.1	14	2166.6	131	16.6	15.1	28.1	24	1.77
ALLERGAN AGN	350.6	24	1006.8	21	36.8	NM	0.4	NM	NM	17.3	12.9	86	0.63
ALPHARMA ALO	321.4**	40	895.8	22	6.0	NM	26.8	NM	NM	2.9	9.9	NM	2.43
FOREST LABORATORIES FRX ⁽⁹⁾	531.6**	41	1435.5	37	142.8	79	363.2	63	26.9	21.3	25.4	40	2.43
IVAX IVX	319.4	1	872.0	-1	30.8	50	81.9	57	9.6	19.1	22.0	18	0.69
JOHNSON & JOHNSON JNJ	9079.0	13	26895.0	12	1817.0	19	5305.0	16	20.0	19.0	29.3	28	2.09
KING PHARMACEUTICALS KG	315.7	37	856.3	39	84.2	37	214.0	31	26.7	26.7	14.4	13	1.17
LILLY (ELI) LLY	2785.6	-3	8121.9	-7	683.9	17	1971.6	-11	24.6	20.4	31.0	24	2.36
MERCK MRK	12892.9	8	37871.9	8	1884.0	-3	5259.7	-3	14.6	16.3	42.4	17	3.12

CORPORATE SCOREBOARD

COMPANY SYMBOL	SALES				PROFITS				MARGINS		RETURN ON COMMON EQUITY 12 MONTHS ENDING 9-30	PRICE-EARNINGS RATIO 10-31	12 MONTH EARN PER SHARE
	3RD QUARTER 2002 \$ MIL.	CHANGE FROM 2001 %	9 MONTHS 2002 \$ MIL.	CHANGE FROM 2001 %	3RD QUARTER 2002 \$ MIL.	CHANGE FROM 2001 %	9 MONTHS 2002 \$ MIL.	CHANGE FROM 2001 %	3RD QUARTER 2002 %	3RD QUARTER 2001 %			
MYLAN LABORATORIES MYL ⁽⁹⁾	319.5	12	877.6	14	68.2	6	197.4	26	21.4	22.4	18.8	15	2.1
PFIZER PFE	8725.0	12	25177.0	9	2350.0	13	6680.0	15	26.9	26.5	45.9	23	1.3
PHARMACIA PHA	3579.0	1	10259.0	1	592.0	26	1867.0	71	16.5	13.3	17.2	27	1.5
SCHERING-PLOUGH SGP	2421.0	2	7810.0	7	429.0	-29	1662.0	-8	17.7	25.3	23.1	17	1.2
WYETH WYE	3623.7	-2	10770.0	5	1401.4	456	2873.2	96	38.7	6.8	76.4	12	2.7
INDUSTRIALS SECTOR													
SECTOR COMPOSITE	240264.2	5	703244.2	2	7736.3	-4	24430.1	-23	3.2	3.5	10.1	28	1.0
16 CAPITAL GOODS													
INDUSTRY GROUP COMPOSITE	153787.5	6	451269.8	3	5685.6	-16	17415.9	-30	3.7	4.7	12.5	22	1.3
(A) AEROSPACE & DEFENSE													
INDUSTRY COMPOSITE	48173.3	3	143438.2	3	2607.1	173	8111.1	39	5.4	2.0	13.4	17	2.3
BOEING BA	12696.0	-7	40374.0	-5	372.0	-43	1729.0	-37	2.9	4.7	16.8	13	2.2
GENCORP GY ⁽¹⁾	266.0	-25	818.0	-27	8.0	167	17.0	-23	3.0	0.8	35.5	3	2.8
GENERAL DYNAMICS GD	3289.0	9	9921.0	15	268.0	17	760.0	9	8.1	7.6	20.2	16	4.9
GOODRICH GR	882.1	-16	2728.8	-13	46.0	-44	154.2	-32	5.2	7.8	10.0	15	0.9
HONEYWELL INTERNATIONAL HON	5569.0	-4	16419.0	-8	412.0	NM	1247.0	NM	7.4	NM	13.2	14	1.6
L-3 COMMUNICATIONS HOLDINGS LLL	1053.6	70	2705.6	65	61.8	85	132.6	87	5.9	5.4	8.5	23	2.0
LOCKHEED MARTIN LMT	6542.0	5	18798.0	13	300.0	NM	875.0	363	4.6	NM	9.5	36	1.6
NORTHROP GRUMMAN NOC	4214.0	24	12376.0	40	141.0	53	471.0	48	3.3	2.7	7.7	20	5.2
PRECISION CASTPARTS PCP ⁽⁹⁾	532.3	-18	1748.8	-9	40.9	169	131.4	4	7.7	2.3	7.1	14	1.3
RAYTHEON RTN	4092.0	9	12098.0	4	228.0	NM	600.0	NM	5.6	NM	6.1	18	1.6
ROCKWELL COLLINS COL ⁽³⁾	698.0	-14	1929.0	-14	70.0	NM	188.0	132	10.0	NM	23.9	18	1.2
UNITED DEFENSE INDUSTRIES UDI	529.7	93	1204.2	32	46.7	938	93.3	267	8.8	1.6	NM	11	2.0
UNITED TECHNOLOGIES UTX	7299.0**	5	20997.0	0	612.0	8	1703.0	7	8.4	8.2	20.8	15	4.0
WORLD FUEL SERVICES INT ⁽⁹⁾	510.6	46	1320.8	25	0.7	-79	9.6	-24	0.1	1.0	11.5	16	1.3
(B) BUILDING PRODUCTS													
INDUSTRY COMPOSITE	7262.3	5	20845.2	2	-2107.5	NM	-1698.5	NM	NM	2.9	NM	NM	-5.5
AMERICAN STANDARD ASD	2070.0	10	5919.0	4	114.0	27	297.0	8	5.5	4.8	199.4	15	4.3
LENNOX INTERNATIONAL LII	818.8	-1	2321.4	-3	27.6	82	53.8	NM	3.4	1.8	2.9	68	0.1
NCI BUILDING SYSTEMS NCS ⁽²⁾	257.8	0	699.6	2	12.6	77	20.5	83	4.9	2.7	8.8	13	1.3
NORTEK NTK	506.9	8	1458.2	7	16.7	139	49.7	104	3.3	1.5	17.3	9	4.9
OWENS CORNING OWC	1306.0	1	3698.0	3	-2359.0	NM	-2329.0	NM	NM	2.1	NM	NM	-42.4
UNIVERSAL FOREST PRODUCTS UFPI	453.0	5	1299.6	8	10.6	9	32.1	11	2.4	2.3	13.9	9	1.9
USG USG	903.0	7	2617.0	6	44.0	63	118.0	372	4.9	3.2	20.8	2	2.5
YORK INTERNATIONAL YRK	946.8	0	2832.4	-4	26.0	56	59.5	47	2.8	1.8	9.9	15	1.6
(C) CONSTRUCTION & ENGINEERING													
INDUSTRY COMPOSITE	4334.7	42	11419.7	27	99.9	25	250.0	29	2.3	2.6	12.9	11	2.26
BUTLER MFG. BBR	238.5	-4	634.8	-4	1.7	-71	-3.4	NM	0.7	2.4	-1.2	NM	-0.3
EMCOR GROUP EME	1052.3	24	2849.0	11	19.5	27	41.6	28	1.9	1.8	12.6	13	3.84
JACOBS ENGINEERING GROUP JEC ⁽³⁾	1211.7	24	3527.5	17	29.0	23	83.8	24	2.4	2.4	15.9	15	1.98
SHAW GROUP SGR ⁽⁴⁾	1248.2	224	2717.1	143	31.3	62	79.4	63	2.5	5.0	14.2	7	2.26
URS URS ⁽²⁾	583.9	-1	1691.3	2	18.4	17	48.6	28	3.1	2.7	11.7	7	2.66
(D) ELECTRICAL EQUIPMENT													
INDUSTRY COMPOSITE	3273.2	4	9506.7	-1	172.4	NM	426.2	167	5.3	NM	9.0	24	0.82
ACUITY BRANDS AY ⁽⁴⁾	515.3	2	1491.1	1	15.4	140	40.5	50	3.0	1.3	12.9	10	1.26
AMERICAN POWER CONVERSION APCC	337.1	-5	942.1	-12	42.0	88	88.2	5	12.5	6.3	9.2	22	0.60
AMETEK AME	257.0	0	788.0	1	21.4	21	62.4	14	8.3	6.9	19.2	16	2.2
ENERGIZER HOLDINGS ENR ⁽³⁾	442.4	2	1172.0	3	56.2	NM	116.0	NM	12.7	NM	26.4	15	2.01
GENERAL CABLE GGC	347.4	-11	1102.5	-15	-4.0	NM	-10.9	NM	NM	0.4	-8.1	NM	-0.23
GENLYTE GROUP GLYT	248.3	-2	728.1	-3	11.0	10	30.4	13	4.4	4.0	14.1	12	3.00
HUBBELL HUBB	445.8	37	1161.6	15	31.1	59	81.4	30	7.0	6.0	9.1	30	1.12
SMITH (A.O.) ADS	352.4	31	1110.6	24	10.0	NM	40.1	105	2.8	0.1	5.7	17	1.29
THOMAS & BETTS TNB	327.5	-12	1010.8	-13	-10.6	NM	-21.9	NM	NM	NM	-16.7	NM	-1.80
(E) INDUSTRIAL CONGLOMERATES													
INDUSTRY COMPOSITE	49690.3	8	147371.6	3	3069.0	-33	5730.8	-61	6.2	9.9	16.0	22	1.24
CARLISLE CSL	500.0	8	1507.4	6	19.9	83	57.5	233	4.0	2.4	11.0	17	2.13
GENERAL ELECTRIC GE	32128.0**	9	95722.0	4	4087.0	25	12031.0	18	12.7	11.1	25.6	16	1.59
TELEFLEX TFX	508.2	9	1562.9	9	26.3	19	90.2	9	5.2	4.7	13.6	14	3.01
TEXTRON TXT	2554.0**	-9	7796.0	-15	71.0	NM	233.0	NM	2.8	NM	14.3	12	3.46
3M MMM	4143.0	5	12194.0	0	545.0	38	1463.0	39	13.2	9.9	27.8	27	4.66
TYCO INTERNATIONAL TYC ⁽³⁾	9357.8	10	27143.0	4	-1701.3	NM	-8202.8	NM	NM	14.0	-10.8	NM	-1.40
WALTER INDUSTRIES WLT	499.3	1	1446.3	-2	21.1	55	58.8	90	4.2	2.7	19.2	7	1.59
(F) MACHINERY													
INDUSTRY COMPOSITE	36761.2	8	106200.1	3	1655.7	99	4050.2	27	4.5	2.4	8.4	24	1.54
AGCO AG	687.8	19	2079.0	18	9.7	NM	21.7	NM	1.4	0.1	5.7	42	0.61
BRIGGS & STRATTON BGG ⁽⁶⁾	238.2	8	1214.3	24	-7.0	NM	61.1	260	NM	NM	14.5	14	2.67
CATERPILLAR CAT	5075.0	0	14775.0	-4	213.0	4	493.0	-23	4.2	4.1	11.0	22	1.90

CORPORATE SCOREBOARD

COMPANY SYMBOL	SALES				PROFITS				MARGINS		RETURN ON COMMON EQUITY 12 MONTHS ENDING 9-30	PRICE-EARNINGS RATIO 10-31	12 MONTHS' EARNINGS PER SHARE
	3RD QUARTER 2002 \$ MIL	CHANGE FROM 2001 %	9 MONTHS 2002 \$ MIL	CHANGE FROM 2001 %	3RD QUARTER 2002 \$ MIL	CHANGE FROM 2001 %	9 MONTHS 2002 \$ MIL	CHANGE FROM 2001 %	3RD QUARTER 2002 %	3RD QUARTER 2001 %			
CRANE CR	386.0	-9	1149.1	-5	20.5	15	67.8	-4	5.3	4.2	12.3	13	1.43
CUMMINS CUM	1648.0	17	4439.0	5	39.0	NM	23.0	NM	2.4	0.2	2.5	35	0.68
DANAHER DHR	1151.7	28	3302.3	15	116.0	32	302.4	14	10.1	9.7	11.6	27	2.18
DEERE DE (2)	3969.0**	10	10477.6	3	147.6	106	251.2	-2	3.7	2.0	-1.6	NM	-0.32
DONALDSON DCI (5)	303.9	2	837.6	-1	24.9	9	67.2	14	8.2	7.7	22.7	17	1.90
DOVER DOV	1076.1	0	3180.8	-6	57.3	904	168.1	27	5.3	0.5	4.7	25	1.01
EATON ETN	1830.0	5	5434.0	-3	93.0	133	214.0	54	5.1	2.3	9.4	20	3.40
FLOWSERVE FLS	586.7	25	1626.5	18	9.8	69	43.2	NM	1.7	1.2	7.9	10	1.23
HARSCO HSC	510.5	0	1479.5	-3	24.7	-10	64.5	1	4.8	5.4	9.7	14	1.78
ILLINOIS TOOL WORKS ITW	2401.0	4	7040.3	0	244.3	23	703.9	15	10.2	8.6	13.7	21	2.89
INGERSOLL-RAND IR	2518.1	6	7411.4	4	89.3	163	277.6	90	3.5	1.4	10.5	17	2.23
ITT INDUSTRIES ITT	1235.1	10	3741.0	7	120.4	78	284.8	41	9.7	6.0	17.9	20	3.19
JLG INDUSTRIES JLG (5)	248.8	-12	613.9	-16	8.3	48	10.5	-50	3.4	2.0	5.5	27	0.30
JOY GLOBAL JOYG (2)	302.3	4	877.9	4	-1.3	NM	-29.2	NM	NM	20.5	-22.4	NA	NA
KENAMETAL KMT (6)	404.2	-1	1201.0	-9	10.8	-13	39.3	-8	2.7	3.1	5.1	28	1.13
LINCOLN ELECTRIC HOLDINGS LECO	247.5	3	755.5	2	18.3	-5	48.5	-23	7.4	8.0	14.0	15	1.62
MANITOWOC MTW	409.9	36	1057.5	28	14.7	18	41.4	3	3.6	4.1	14.8	12	2.01
MUELLER INDUSTRIES MLI	238.5**	-4	771.6	-3	24.9	36	59.0	12	10.4	7.4	9.5	14	1.98
NACCO INDUSTRIES NC	624.1	4	1810.2	-9	8.0	NM	17.1	NM	1.3	NM	-1.9	NM	-1.29
NAVISTAR INTERNATIONAL NAV (2)	1588.0	0	4728.0	-3	-16.0	NM	-76.0	NM	NM	0.1	-6.6	NM	-1.16
OSHKOSH TRUCK OSK (3)	477.0	15	1382.1	19	17.2	-2	51.0	20	3.6	4.3	14.5	17	3.45
PACCAR PCAR	1996.3	33	5299.6	16	128.9	227	249.8	103	6.5	2.6	11.8	17	2.59
PALL PLL (5)	428.9	29	1016.7	6	9.0	-65	53.8	-42	2.1	7.7	8.9	29	0.59
PARKER HANNIFIN PH (6)	1585.9	7	4821.8	7	61.0	1	101.5	-50	3.8	4.1	5.0	39	1.12
PENTAIR PNR	629.3	-1	1940.5	-2	37.3	51	101.7	38	5.9	3.9	7.8	19	1.71
RELIAANCE STEEL & ALUMINUM RS	454.8	6	1310.5	3	10.0	28	28.2	-12	2.2	1.8	5.3	20	1.03
SPX SPW	1286.2	6	3674.2	31	75.8	28	199.2	84	5.9	4.9	14.6	13	3.17
STEWART & STEVENSON SERVICES SVC (11)	278.8	-25	883.2	-13	4.6	-63	9.7	-78	1.6	3.3	5.5	15	0.73
TECUMSEH PRODUCTS TECUA	310.9	-1	1039.6	-5	14.2	173	44.8	22	4.6	1.7	5.3	16	2.76
TEREX TEX	674.1	49	1946.3	42	11.4	NM	22.8	69	1.7	NM	3.4	18	0.64
TIMKEN TKR	628.6	9	1905.2	2	1.8	NM	15.0	NM	0.3	NM	2.0	67	0.27
UNOVA UNA	329.9	-8	977.5	-17	14.3	NM	18.4	NM	4.3	NM	-2.4	NM	-0.20
(G) TRADING COMPANIES & DISTRIBUTORS													
INDUSTRY COMPOSITE	4292.6	2	12488.4	-1	188.8	8	546.2	13	4.4	4.1	13.4	20	1.66
APPLIED INDUSTRIAL TECHNOLOGIES AIT (6)	368.0	0	1099.0	-6	3.9	-20	10.9	-41	1.1	1.3	4.6	25	0.71
FASTENAL FAST	238.1	14	686.2	11	19.1	12	57.9	2	8.0	8.1	14.9	36	0.94
GENUINE PARTS GPC	2156.8	3	6265.4	0	94.0	7	277.1	2	4.4	4.2	14.5	17	1.73
GRAINGER (W.W.) GWW	1203.4	0	3523.5	-3	60.0	7	172.9	53	5.0	4.7	14.1	20	2.47
WATSCO WSO	326.3	-3	914.3	-5	11.8	47	27.4	17	3.6	2.4	8.6	15	1.06
17 COMMERCIAL SERVICES & SUPPLIES													
INDUSTRY GROUP COMPOSITE	34846.5	8	101841.9	4	2370.3	57	7255.2	28	6.8	4.7	15.1	24	1.02
ABM INDUSTRIES ABM (2)	543.8**	0	1597.2	0	12.6	-5	34.6	3	2.3	2.4	8.8	22	0.66
ALLIED WASTE INDUSTRIES AW	1429.2	1	4146.8	-1	63.7	248	168.0	169	4.5	1.3	15.4	15	0.55
APOLLO GROUP APOL (4)	282.3	31	781.3	32	49.3	58	128.2	54	17.5	14.5	25.6	48	0.87
AUTOMATIC DATA PROCESSING ADP (6)	2410.1**	9	7527.3	10	210.4	7	850.0	15	8.7	8.9	23.5	24	1.78
AVERY DENNISON AVY	1114.5	15	3101.6	7	63.1	2	201.7	9	5.7	6.4	25.5	24	2.63
BANTA BN	352.1	-7	1018.3	-7	19.5	4	43.4	28	5.6	5.0	12.9	13	2.35
BLOCK (H&R) HRB (8)	431.4	31	3046.2	14	-9.5	NM	483.7	39	NM	NM	33.9	18	2.42
CDI CDI	287.8	-18	899.3	-20	-0.6	NM	-2.1	NM	NM	NM	-6.8	NM	-1.07
CENOANT CD	3839.0	61	10238.0	67	253.0	36	834.0	25	6.6	7.8	4.9	27	0.42
CERIOIAN CEN	288.6	2	878.2	-1	21.8	6	64.9	143	7.6	7.3	7.4	24	0.58
CERTEGY CEY	254.5	7	744.7	9	24.4	2	63.4	5	9.6	10.1	40.2	16	1.29
CINTAS CTAS (7)	665.7	18	1815.0	9	61.6	9	181.4	6	9.3	10.0	16.1	34	1.39
CONCORD EFS CEFT	568.3	30	1568.6	27	94.3	16	211.8	67	16.6	18.7	14.2	25	0.57
CONVERGYS CVG	561.2	-1	1721.4	0	55.6	NM	174.3	112	9.9	0.5	19.8	11	1.36
DELUXE DLX	319.8	-1	977.1	2	52.7	3	161.9	17	16.5	15.8	349.4	14	3.25
DONNELLEY (R.R.) DNY	1177.3	-9	3419.8	-12	47.7	14	94.2	50	4.1	3.3	6.5	41	0.49
DST SYSTEMS DST	578.0	-6	1779.2	-1	51.1	5	163.6	-8	8.8	7.9	14.5	17	1.76
DUN & BRASTREET DNB	297.2	2	920.9	-5	33.2	14	79.0	-18	11.2	10.0	NM	21	1.72
EQUIFAX EFX	289.7	3	816.7	-5	49.7	39	139.6	29	17.2	12.7	52.2	22	1.07
FIRST DATA FDC	1988.6**	13	5686.0	11	342.5	127	885.4	51	17.2	8.6	30.9	23	1.51
FISERV FISV	635.7	18	1900.0	18	66.2	26	197.9	27	10.4	9.8	14.2	24	1.29
GEVITY HR GVHR	864.4	8	2483.2	6	1.3	NM	3.4	NM	0.2	NM	3.6	40	0.10
HON INDUSTRIES HNI	446.3	-3	1244.7	-9	27.2	-5	63.2	24	6.1	6.2	13.5	17	1.47
KELLY SERVICES KELYA	1122.7	5	3199.7	-1	6.5	42	11.2	-29	0.6	0.4	2.0	72	0.33
LABOR READY LRW	250.9	-3	640.1	-9	8.5	8	8.3	8	3.4	3.0	7.5	29	0.24
MANPOWER MAN	2885.9	8	7772.8	-2	40.5	9	73.1	-26	1.4	1.4	10.7	27	1.28
MILLER (HERMAN) MLHR (7)	346.9	-15	1010.2	-32	9.8	NM	-20.6	NM	2.8	NM	-16.2	NM	-0.57
PAYCHEX PAYX (7)	575.4	23	1636.7	18	75.9	8	211.6	4	13.2	14.9	28.8	39	0.74

CORPORATE SCOREBOARD

COMPANY SYMBOL	SALES				PROFITS				MARGINS		RETURN ON COMMON EQUITY 12 MONTHS ENDING 9-30	PRICE- EARNINGS RATIO 10-31	12 MONTHS EARNINGS PER SHARE
	3RD QUARTER 2002 \$ MIL.	CHANGE FROM 2001 %	9 MONTHS 2002 \$ MIL.	CHANGE FROM 2001 %	3RD QUARTER 2002 \$ MIL.	CHANGE FROM 2001 %	9 MONTHS 2002 \$ MIL.	CHANGE FROM 2001 %	3RD QUARTER 2002 %	3RD QUARTER 2001 %			
PITNEY BOWES PBI	1114.1	7	3244.9	7	146.9	20	419.5	1	13.2	11.7	56.7	16	2.14
REGIS RGIS (6)	399.2	14	1145.2	12	19.7	28	59.4	36	4.9	4.4	16.4	17	1.72
REPUBLIC SERVICES RSG	609.7	5	1759.8	4	62.2	10	178.1	8	10.2	9.7	7.8	25	0.84
ROBERT HALF INTERNATIONAL RH	484.8	-16	1426.4	-27	-3.1	NM	9.2	-91	NM	4.0	2.9	NM	0.12
SABRE HOLDINGS TSG	510.6**	-3	1582.7	-6	57.9	235	213.3	836	11.3	3.3	8.7	20	0.98
SERVICEMASTER SVM	1013.5	3	2779.7	2	55.3	55	142.3	46	5.5	3.6	-10.3	NM	-0.41
STANOARO REGISTER SR	252.7	-9	770.3	-15	6.5	NM	28.3	NM	2.6	NM	12.4	17	1.40
STEELCASE SCS (10)	659.3	-17	1962.8	-27	-7.3	NM	-57.0	NM	NM	0.8	-3.8	NM	-0.35
UNITED STATIONERS USTR	932.5	-2	2778.2	-7	18.9	NM	58.8	57	2.0	NM	13.9	13	2.30
VIAO VVI	418.0	7	1271.5	-2	35.6	NM	100.2	286	8.5	NM	16.4	14	1.43
VOLT INFORMATION SCIENCES VOL (2)	376.6	-18	1082.8	-27	1.1	NM	-8.7	NM	0.3	NM	-1.1	NM	-0.18
WALLACE COMPUTER SERVICES WCS (5)	372.4	-8	1136.5	-10	13.4	129	17.6	-52	3.6	1.4	6.6	26	0.71
WASTE MANAGEMENT WMI	2896.0	0	8330.0	-2	231.0	645	585.0	70	8.0	1.1	13.7	19	1.20

18 TRANSPORTATION

INDUSTRY GROUP COMPOSITE	51630.1	2	150132.5	-4	-319.6	NM	-241.0	NM	NM	NM	-1.6	NM	-0.27
(A) AIR FREIGHT & LOGISTICS													
INDUSTRY COMPOSITE	18330.7	6	53672.0	2	863.3	22	2562.7	29	4.7	4.1	15.3	28	1.87
AIRBORNE ABF	842.8	9	2441.7	1	-3.1	NM	2.7	NM	NM	0.2	0.6	NM	0.10
CNF CNF	1230.1	4	3483.5	-6	45.6	NM	87.8	NM	3.7	NM	-18.1	NM	-2.94
FEDEX FDX (7)	5445.0	8	15880.0	6	158.0	27	514.0	49	2.9	2.5	11.4	21	2.50
HUNT (J.B.) TRANSPORT SERVICES JBHT	582.7	8	1650.2	6	16.8	268	37.1	151	2.9	0.8	9.9	19	1.46
PACER INTERNATIONAL PACR	391.5	-2	1175.0	-7	8.2	720	17.0	467	2.1	0.3	12.2	18	0.66
ROBINSON (C.H.) WORLDWIDE CHRW	872.2	11	2455.0	6	26.0	15	72.0	14	3.0	2.9	22.7	28	1.07
RYDER SYSTEM R	1212.4	-2	3571.6	-6	33.8	NM	80.1	333	2.8	NM	6.2	18	1.29
UNITED PARCEL SERVICE UPS	7754.0	5	23015.0	3	578.0	2	1752.0	-2	7.5	7.7	22.4	28	2.12
(B) AIRLINES													
INDUSTRY COMPOSITE	19512.1	-3	56553.3	-12	-2206.5	NM	-5300.8	NM	NM	NM	-62.2	NM	-5.52
ALASKA AIR GROUP ALK	620.1	5	1696.8	0	10.6	-58	-28.0	NM	1.7	4.3	-7.7	NM	-2.42
AMERICA WEST HOLDINGS AWA	520.4	6	1524.8	-8	-31.0	NM	-125.5	NM	NM	NM	NM	NM	-5.53
AMR AMR	4494.0	-7	13109.0	-14	-924.0	NM	-1994.0	NM	NM	NM	NM	NM	-18.00
ATA HOLDINGS ATAH	317.3	-1	966.4	-6	-60.6	NM	-114.1	NM	NM	0.1	NM	NM	-17.09
CONTINENTAL AIRLINES CAL	2178.0	-2	6364.0	-12	-37.0	NM	-342.0	NM	NM	0.1	-43.6	NM	-7.94
DELTA AIR LINES DAL	3420.0	1	9997.0	-9	-326.0	NM	-909.0	NM	NM	NM	-58.3	NM	-13.44
EXPRESSJET HOLDINGS XJT	270.1	8	805.1	7	21.6	82	62.3	66	8.0	4.8	NM	9	1.23
NORTHWEST AIRLINES NWAC	2564.0	-1	7150.0	-10	-46.0	NM	-310.0	NM	NM	0.7	NM	NM	-6.19
SOUTHWEST AIRLINES LUV	1391.2	4	4121.2	-5	74.9	-50	198.6	-56	5.4	11.3	6.1	44	0.33
UAL UAL	3737.0	-9	10819.0	-18	-889.0	NM	-1739.0	NM	NM	NM	NM	NM	-36.55
(C) MARINE													
INDUSTRY COMPOSITE	293.7	12	803.8	-3	16.3	-4	33.2	-48	5.5	6.5	12.1	11	2.19
ALEXANDER & BALOWIN ALEX	293.7	12	803.8	-3	16.3	-4	33.2	-48	5.5	6.5	12.1	11	2.19
(D) ROAD & RAIL													
INDUSTRY COMPOSITE	13493.6	3	39103.4	0	1007.3	37	2463.9	27	7.5	5.6	8.7	15	1.96
ARKANSAS BEST ABFS	375.4	-2	1040.7	-12	18.3	41	26.3	-18	4.9	3.4	10.4	21	1.43
BURLINGTON NORTHERN SANTA FE BNI	2308.0	-1	6678.0	-3	192.0	-15	558.0	0	8.3	9.6	9.1	13	1.92
CSX CSX	2055.0	2	6092.0	0	127.0	27	330.0	45	6.2	5.0	6.2	15	1.86
DOLLAR THRIFTY AUTOMOTIVE GROUP DTG	337.7	10	882.9	7	21.2	251	50.9	84	6.3	2.0	7.6	13	1.48
GATX GMT	323.5	-11	957.8	-16	19.1	NM	58.4	198	5.9	NM	5.4	21	0.95
LANOSTAR SYSTEM LSTR	385.7	8	1112.6	6	13.9	17	34.7	11	3.6	3.4	30.3	18	2.77
NORFOLK SOUTHERN NSC	1598.0	6	4689.0	1	126.0	59	331.0	34	7.9	5.2	6.9	18	1.15
ROADWAY ROAD	721.3	14	2055.6	7	6.9	-15	10.9	-37	1.0	1.3	6.8	31	1.30
SWIFT TRANSPORTATION SWFT	537.0	0	1541.3	-3	16.3	486	43.4	206	3.0	0.5	7.3	25	0.65
UNION PACIFIC UNP	3199.0	6	9320.0	4	437.0	64	963.0	39	13.7	8.8	11.8	13	4.70
USFREIGHTWAYS USFC	634.5	3	1837.0	-1	5.3	-45	3.6	-88	0.8	1.6	2.0	61	0.46
WERNER ENTERPRISES WERN	336.1	4	989.1	4	16.8	35	44.0	29	5.0	3.9	9.2	23	0.88
YELLOW YELL	682.5	7	1907.3	0	7.3	42	9.8	-15	1.1	0.8	3.0	68	0.41

INFORMATION TECHNOLOGY SECTOR

SECTOR COMPOSITE	150832.8	4	439823.5	-8	-5329.6	NM	-12482.5	NM	NM	NM	-3.4	NM	-0.20
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19 SOFTWARE & SERVICES

INDUSTRY GROUP COMPOSITE	28749.7	8	86076.1	5	3505.4	257	5115.4	NM	12.2	3.7	7.5	59	0.43
(A) INTERNET SOFTWARE & SERVICES													
INDUSTRY COMPOSITE	1168.3	31	3296.3	30	-53.9	NM	-4922.0	NM	NM	NM	NM	NM	-5.00
EARTHLINK ELNK	340.7	7	1009.6	10	-25.7	NM	-115.1	NM	NM	NM	-27.7	NM	-1.42
HOTELS.COM ROOM	277.4	83	672.8	70	22.6	NM	54.4	571	8.1	1.1	10.0	62	1.01
VERISIGN VRSN	301.4	18	946.7	35	-79.7	NM	-4921.9	NM	NM	NM	NM	NM	22.74
YAHOO YHOO	248.8	50	667.3	26	28.9	NM	60.7	NM	11.6	NM	2.4	NM	0.08
(B) IT CONSULTING & SERVICES													
INDUSTRY COMPOSITE	13519.5	3	40426.1	3	342.3	NM	1587.2	21	2.5	NM	11.5	17	0.92

CORPORATE SCOREBOARD

COMPANY SYMBOL	SALES				PROFITS				MARGINS		RETURN ON COMMON EQUITY 12 MONTHS ENDING 9-30	PRICE- EARNINGS RATIO 10-31	12 MONTHS' EARNINGS PER SHARE
	3RD QUARTER 2002 \$ MIL.	CHANGE FROM 2001 %	9 MONTHS 2002 \$ MIL.	CHANGE FROM 2001 %	3RD QUARTER 2002 \$ MIL.	CHANGE FROM 2001 %	9 MONTHS 2002 \$ MIL.	CHANGE FROM 2001 %	3RD QUARTER 2002 %	3RD QUARTER 2001 %			
ACCENTURE ACN ⁽⁴⁾	2691.7	-3	8585.6	0	38.1	NM	163.2	NM	1.4	NM	55.8	30	0.56
AFFILIATED COMPUTER SERVICES ACS ⁽⁶⁾	897.9	37	2555.3	47	69.5	58	199.6	73	7.7	6.7	11.8	25	1.87
AMERICAN MANAGEMENT SYSTEMS AMSY	247.5	-12	750.6	-19	8.3	361	20.2	70	3.4	0.6	5.9	21	0.57
BEARINGPOINT BE ⁽⁶⁾	747.6	23	1913.1	-8	15.2	-32	39.3	-47	2.0	3.7	4.6	28	0.28
BELL MICROPRODUCTS BELM	551.9	13	1572.5	6	-2.4	NM	-8.0	NM	NM	NM	-5.6	NM	-0.40
ELECTRONIC DATA SYSTEMS EDS	5406.0	-3	16221.0	4	86.0	-59	755.0	-23	1.6	3.8	15.9	6	2.36
MPS GROUP MPS	289.4	-22	874.5	-28	5.3	391	11.4	3	1.8	0.3	1.1	67	0.08
PEROT SYSTEMS PER	342.5	12	994.5	11	18.7	NM	58.3	NM	5.5	NM	10.0	19	0.57
SUNGAR OATA SYSTEMS SDS	659.9	38	1891.5	35	78.1	25	229.8	27	11.8	13.1	14.1	22	1.01
TITAN TTN	352.8	49	1012.8	49	-33.5	NM	-15.4	NM	NM	1.2	-2.5	NM	-0.29
UNISYS UIS	1332.3	-3	4054.6	-9	59.0	182	133.9	12	4.4	1.5	-1.6	NM	-0.12
(C) SOFTWARE													
INDUSTRY COMPOSITE	14061.9	12	42353.7	5	3217.0	114	8450.1	85	22.9	12.0	13.9	37	0.75
AOOBE SYSTEMS ADBE ⁽¹⁾	284.9	-2	870.1	-10	47.2	17	151.3	-12	16.6	13.8	24.4	31	0.76
BMC SOFTWARE BMC ⁽⁹⁾	291.2	-1	928.1	-12	10.1	NM	13.5	NM	3.5	NM	-5.7	NM	-0.34
CADENCE DESIGN SYSTEMS CDN	327.2	-9	1016.8	-3	8.2	-94	-16.7	NM	2.5	35.4	1.5	NM	0.08
COMPUTER ASSOCIATES INTERNATIONAL CA ⁽⁹⁾	772.0	5	2309.0	6	-52.0	NM	-355.0	NM	NM	NM	-12.9	NM	-1.01
COMPUWARE CPWR ⁽⁹⁾	358.0	-16	1111.8	-20	33.8	28	-279.6	NM	9.5	6.2	-19.9	NM	-0.67
ELECTRONIC ARTS ERTS ⁽⁹⁾	453.5	89	1255.1	72	50.2	NM	104.9	NM	11.1	NM	17.0	41	1.59
MICROSOFT MSFT ⁽⁶⁾	7746.0	26	22244.0	16	2726.0	112	6989.0	84	35.2	20.9	17.3	32	1.68
NOVELL NOVL ⁽²⁾	282.3	13	834.0	13	9.9	NM	-11.4	NM	3.5	NM	-9.3	NM	-0.29
ORACLE ORCL ⁽⁷⁾	2027.5	-10	7054.6	-15	342.7	-33	1506.6	-23	16.9	22.5	35.9	28	0.37
PEOPLESFT PSFT	471.2	-10	1436.7	-9	44.6	-11	125.2	-6	9.5	9.7	9.9	32	0.56
SIEBEL SYSTEMS SEBL	357.2	-18	1240.6	-22	-92.1	NM	2.3	-99	NM	8.0	3.4	58	0.13
SYMANTEC SYMC ⁽⁹⁾	325.2	34	952.1	32	52.0	NM	113.3	NM	16.0	NM	7.9	56	0.72
VERITAS SOFTWARE VRTS	365.7	7	1100.8	-2	36.2	NM	106.7	NM	9.9	NM	-3.3	NM	-0.25
20 TECHNOLOGY HARDWARE & EQUIPMENT													
INDUSTRY GROUP COMPOSITE	122083.1	3	353747.4	-10	-8835.0	NM	-17597.9	NM	NM	NM	-7.7	NM	-0.42
(A) COMMUNICATIONS EQUIPMENT													
INDUSTRY COMPOSITE	17649.3	-21	55389.0	-25	-2671.0	NM	-13471.0	NM	NM	NM	-33.6	NM	-1.08
ANDREW ANDW ⁽³⁾	271.8	5	711.8	-7	-18.5	NM	-4.8	NM	NM	8.6	1.2	72	0.12
AUDIOVOX VOXX ⁽¹⁾	291.4	-7	784.6	-14	1.9	86	2.1	NM	0.6	0.3	-0.4	NM	-0.07
AVAYA AV ⁽³⁾	1152.0	-20	3650.0	-27	-534.0	NM	-636.0	NM	NM	NM	NM	NM	-2.41
CISCO SYSTEMS CSCO ⁽⁵⁾	4829.0	12	14467.0	-8	772.0	NM	2161.0	NM	16.0	0.2	6.6	45	0.25
CORNING GLW	837.0**	-45	2631.0	-50	-133.0	NM	-593.0	NM	NM	NM	-26.7	NM	-1.43
HARRIS HRS ⁽⁶⁾	450.2	2	1431.1	-1	19.9	16	69.0	20	4.4	3.9	7.4	20	1.29
LUCENT TECHNOLOGIES LU ⁽³⁾	2277.0	-56	8742.0	-48	-2809.0	NM	-11403.0	NM	NM	NM	NM	NM	-3.51
MOTOROLA MOT	6371.0	-14	19133.0	-15	111.0	NM	-2659.0	NM	1.7	NM	-34.4	NM	-1.72
SCIENTIFIC-ATLANTA SFA ⁽⁶⁾	311.6	-24	1154.4	-32	11.0	-70	39.1	-79	3.5	9.0	5.5	24	0.50
TELLABS TLAB	288.1	-36	1004.2	-42	-91.1	NM	-228.6	NM	NM	NM	-13.2	NM	-0.75
3COM COMS ⁽⁷⁾	304.7	-22	999.2	-33	-32.0	NM	-291.9	NM	NM	NM	-20.6	NM	-1.13
UTSTARCOM UTSI	265.5	56	680.7	58	30.7	64	74.0	83	11.6	11.0	12.5	22	0.78
(B) COMPUTERS & PERIPHERALS													
INDUSTRY COMPOSITE	56211.1	13	156029.8	-3	31.1	93	3332.1	-33	0.1	0.0	6.4	51	0.41
APPLE COMPUTER AAPL ⁽³⁾	1443.0	0	4367.0	0	-45.0	NM	27.0	-84	NM	4.6	1.6	89	0.18
DELL COMPUTER DELL ⁽¹¹⁾	8459.0	11	24586.0	1	501.0	NM	1414.0	78	5.9	NM	40.4	41	0.69
EMC EMC	1259.4	4	3949.0	-29	21.3	NM	-54.8	NM	1.7	NM	-1.7	NM	-0.05
GATEWAY GTW	1117.8	-21	3115.0	-37	-46.9	NM	-228.5	NM	NM	NM	-19.9	NM	-0.70
HEWLETT-PACKARD HPQ ⁽²⁾	16536.0	61	38539.0	12	-2029.0	NM	-1313.0	NM	NM	1.1	-3.4	NM	-0.53
IMATION IMN	263.8	-1	795.8	-3	16.4	80	52.2	136	6.2	3.4	3.6	58	0.71
INTERNATIONAL BUSINESS MACHINES IBM	19821.0	0	57502.0	-6	1694.0	-1	3423.0	-39	8.5	8.7	26.1	24	3.30
LEXMARK INTERNATIONAL LXX	1041.0	5	3149.1	6	89.8	28	250.4	6	8.6	7.0	27.6	27	2.17
MAXTOR MXO	819.7	-21	2741.2	2	-105.5	NM	-264.2	NM	NM	NM	-73.0	NM	-1.80
NCR NCR	1377.0	-5	4004.0	-7	41.0	NM	71.0	-53	3.0	NM	8.0	16	1.43
SILICON GRAPHICS SGI ⁽⁶⁾ †	241.7	-36	839.8	-36	-41.1	NM	-67.4	NM	NM	NM	NM	NM	-0.09
STORAGE TECHNOLOGY STK	501.7	1	1449.5	-2	23.9	33	49.0	80	4.8	3.6	8.2	21	0.84
SUN MICROSYSTEMS SUNW ⁽⁶⁾	2747.0	-4	9274.0	-15	-111.0	NM	-87.0	NM	NM	NM	-5.6	NM	-0.16
WESTERN DIGITAL WDC ⁽⁶⁾	582.9	32	1718.4	22	22.2	NM	60.5	NM	3.8	NM	62.2	17	0.36
(C) ELECTRONIC EQUIPMENT & INSTRUMENTS													
INDUSTRY COMPOSITE	26529.0	4	78096.2	-12	-5248.5	NM	-5915.0	NM	NM	NM	-19.4	NM	-1.77
AGILENT TECHNOLOGIES A ⁽²⁾	1391.0	-24	4274.0	-37	-223.0	NM	-787.0	NM	NM	NM	-24.7	NM	-2.68
AMPHENOL APH	268.1	6	795.0	-6	20.7	24	57.9	-14	7.7	6.6	41.3	23	1.71
ANIXTER INTERNATIONAL AXE	626.3	-18	1858.3	-25	10.8	NM	33.1	19	1.7	NM	6.3	23	1.01
ARROW ELECTRONICS ARW	1811.3	-10	5499.2	-26	0.5	NM	3.2	NM	0.0	NM	0.8	NM	0.12
AVNET AVT ⁽⁶⁾	2173.9	-1	6533.1	-20	-0.5	NM	-63.1	NM	NM	NM	-3.7	NM	-0.54

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	3RD QUARTER 2002 \$ MIL.	CHANGE FROM 2001 %	9 MONTHS 2002 \$ MIL.	CHANGE FROM 2001 %	3RD QUARTER 2002 \$ MIL.	CHANGE FROM 2001 %	9 MONTHS 2002 \$ MIL.	CHANGE FROM 2001 %	3RD QUARTER 2002 %	3RD QUARTER 2001 %			
AVX AVX ⁽⁹⁾	295.4	-3	865.4	-32	1.0	NM	0.2	NM	0.3	NM	-0.4	NM	-0.04
BENCHMARK ELECTRONICS BHE	428.3	66	1161.8	15	9.6	NM	23.2	NM	2.2	NM	4.7	23	0.97
DIEBOLD DBD	529.8	19	1414.3	13	44.1	209	110.4	122	8.3	3.2	13.9	20	1.77
GTSI GTSI	276.8	36	654.6	30	3.1	56	4.5	NM	1.1	1.0	13.8	12	1.00
INGRAM MICRO IM	5600.2	-4	16569.6	-13	-8.3	NM	16.0	332	NM	NM	1.3	NM	0.14
JABIL CIRCUIT JBL ⁽⁴⁾	988.2	5	2660.9	-17	1.8	-84	26.3	-63	0.2	1.2	2.3	91	0.17
MOLEX MOLX ⁽⁶⁾	469.2	9	1333.8	-13	30.0	19	77.0	-20	6.4	5.9	4.5	64	0.41
PERKINELMER PKI	366.0	5	1095.4	-2	9.8	-71	-4.8	NM	2.7	9.8	-5.1	NM	-0.53
SANMINA-SCI SANM ⁽³⁾	2602.3	333	7631.2	197	-2607.2	NM	-2651.5	NM	NM	NM	-79.0	NM	-5.60
SCANSOURCE SCSC ⁽⁶⁾	260.6	38	705.8	36	6.0	32	16.5	25	2.3	2.4	16.5	18	3.28
SOLETRON SLR ⁽⁴⁾	3116.6	-13	9124.0	-30	-2647.3	NM	-3059.7	NM	NM	NM	-65.2	NM	-3.98
SYMBOL TECHNOLOGIES SBL	339.5	3	956.7	-15	13.1	NM	-7.9	NM	3.9	NM	0.4	NM	0.03
TECH DATA TECO ⁽¹¹⁾	3996.7	-3	12082.1	-15	35.3	152	106.9	8	0.9	0.3	9.0	14	2.34
THERMO ELECTRON TMO	517.2	1	1517.6	-7	39.0	52	152.9	169	7.5	5.0	7.2	23	0.81
VISHAY INTERTECHNOLOGY VSH	471.4	42	1363.4	7	13.1	NM	31.2	-42	2.8	NM	-0.9	NM	-0.16
(D) OFFICE ELECTRONICS													
INDUSTRY COMPOSITE	4971.3	-7	15220.1	-8	144.3	NM	269.8	188	2.9	NM	8.2	NM	0.06
IKON OFFICE SOLUTIONS IKO ⁽³⁾	1178.3	-8	3617.1	-9	39.3	NM	117.8	NM	3.3	NM	9.8	7	0.99
XEROX XRX	3793.0	-6	11603.0	-8	105.0	NM	152.0	58	2.8	NM	7.6	NM	-0.12
(E) SEMICONDUCTOR EQUIPMENT & PRODUCTS													
INDUSTRY COMPOSITE	16722.4	5	49012.4	-11	-1090.9	NM	-1813.7	NM	NM	NM	-4.0	NM	-0.22
ADVANCED MICRO DEVICES AMD	508.2	-34	2010.6	-32	-254.2	NM	-448.3	NM	NM	NM	-14.3	NM	-1.36
AGERE SYSTEMS AGR.A ⁽³⁾	529.0	-12	1640.0	-40	-885.0	NM	-1436.0	NM	NM	NM	NM	NM	-1.11
AMKOR TECHNOLOGY AMKR	453.9	36	1213.5	4	-59.3	NM	-630.6	NM	NM	NM	NM	NM	-4.69
ANALOG DEVICES ADI ⁽²⁾	445.4	-7	1251.8	-32	31.4	-20	70.5	-79	7.1	8.2	3.2	NM	0.24
APPLIED MATERIALS AMAT ⁽²⁾	1459.7	-7	3616.6	-41	115.2	0	121.8	-86	7.9	7.3	0.5	NM	0.02
ATMEL ATML	298.7	1	889.2	-25	-102.3	NM	-625.6	NM	NM	NM	-69.8	NM	-1.40
BROADCOM BRCM	290.0	36	787.0	7	-183.3	NM	-478.7	NM	NM	NM	-25.2	NM	-3.07
FAIRCHILD SEMICONDUCTOR INTL. FCS	360.6	11	1058.0	-2	4.3	NM	-6.0	NM	1.2	NM	-1.8	NM	-0.21
INTEL INTC	6504.0	-1	19604.0	0	686.0	547	2068.0	163	10.5	1.6	7.3	46	0.38
KLA-TENCOR KLAC ⁽⁶⁾	375.5	-25	1105.8	-36	51.3	-41	131.9	-63	13.7	17.2	8.9	39	0.91
LSI LOGIC LSI	487.0	23	1337.2	-3	-27.6	NM	-261.7	NM	NM	NM	-22.3	NM	-1.39
MAXIM INTEGRATED PRODUCTS MXIM ⁽⁶⁾	285.9	19	824.5	-14	73.2	19	208.5	35	25.6	25.6	15.2	40	0.79
MICRON TECHNOLOGY MU ⁽⁴⁾	748.0	56	2165.1	-8	-586.5	NM	-641.1	NM	NM	NM	-14.4	NM	-1.51
NATIONAL SEMICONDUCTOR NSM ⁽⁷⁾	420.6	24	1209.6	-1	1.3	NM	-19.4	NM	0.3	NM	-3.7	NM	-0.37
NVIDIA NVDA ⁽¹¹⁾	427.3	64	1513.9	110	5.3	-84	164.5	80	1.2	12.7	23.3	10	1.18
ON SEMICONDUCTOR ONNN	272.0	-2	818.8	-14	-20.5	NM	-95.8	NM	NM	NM	NM	NM	-3.19
TERADYNE TER	330.7	33	888.6	-27	-166.8	NM	-294.7	NM	NM	NM	-24.2	NM	2.24
TEXAS INSTRUMENTS TXN	2248.0	22	6237.0	-3	188.0	NM	245.0	NM	8.4	NM	1.2	NM	0.07
XILINX XLNX ⁽⁹⁾	277.9	24	841.2	-9	38.7	NM	114.0	NM	13.9	NM	6.5	53	0.36

MATERIALS SECTOR

SECTOR COMPOSITE	90124.0	6	263331.2	1	2830.5	203	6751.1	202	3.1	1.1	6.3	32	0.79
21 MATERIALS													
INDUSTRY GROUP COMPOSITE	90124.0	6	263331.2	1	2830.5	203	6751.1	202	3.1	1.1	6.3	32	0.79
(A) CHEMICALS													
INDUSTRY COMPOSITE	34438.1	4	104390.8	-2	1362.8	148	4157.7	158	4.0	1.7	15.2	18	1.65
AIR PRODUCTS & CHEMICALS APD ⁽³⁾	1398.0	0	4084.7	-7	144.3	40	411.7	25	10.3	7.4	14.9	19	2.36
AIRGAS ARG ⁽⁹⁾	451.1	9	1324.7	7	19.2	32	42.0	43	4.3	3.5	9.8	20	0.75
ALBEMARLE ALB	263.3	9	733.0	8	20.4	21	57.8	7	7.7	6.9	13.0	17	1.64
ARCH CHEMICALS ARJ	241.6	16	748.9	0	1.9	NM	11.7	-26	0.8	NM	-0.6	NM	-0.12
CABOT CBT ⁽³⁾	440.0	15	1180.0	-7	23.0	-15	67.0	-28	5.2	7.1	11.3	16	1.48
CROMPTON CK	624.7	-4	1959.3	-7	12.6	NM	13.0	NM	2.0	NM	-27.1	NM	-0.65
CYTEC INDUSTRIES CYT	331.8	-3	1001.8	-7	31.6	48	59.9	1	9.5	6.2	9.6	15	1.64
DOW CHEMICAL DOW	7041.0**	5	20520.0	-4	128.0	125	404.0	NM	1.8	0.8	3.8	65	0.40
DUPONT DD	5482.0**	-3	18324.0	-6	469.0	230	1491.0	261	8.6	2.5	48.1	8	5.31
EASTMAN CHEMICAL EMN	1374.0**	0	4005.0	-3	24.0	-11	92.0	NM	1.7	2.0	0.0	NM	-0.01
ECOLAB ECL	894.9	47	2520.2	43	72.1	26	160.8	7	8.1	9.4	18.9	32	1.53
ENGELHARD EC	858.6	-25	2842.7	-33	2.9	-95	115.4	-30	0.3	5.1	16.4	17	1.34
FERRO FOE	388.8	28	1162.2	30	10.0	-12	26.7	-2	2.6	3.8	15.0	31	0.80
FMC FMC	476.6	-1	1393.2	-4	28.2	103	56.4	NM	5.9	2.9	10.8	49	0.62
FULLER (H.B.) FULL ⁽¹⁾	313.9	-1	926.6	-3	9.2	-37	17.8	-44	2.9	4.6	6.8	26	1.08
GEORGIA GULF GGC	342.6	28	912.0	-6	17.1	583	21.5	NM	5.0	0.9	14.3	43	0.51
GRACE (W.R.) GRA	478.7	7	1363.8	5	14.0	-29	47.6	-17	2.9	4.4	NM	2	1.04
GREAT LAKES CHEMICAL GLK	360.6	12	1074.1	0	13.7	NM	40.9	NM	3.8	NM	-1.1	NM	-0.17
HERCULES HPC	443.0	5	1282.0	-7	-35.0	NM	-59.0	NM	NM	NM	-28.6	NM	-0.54
IMC GLOBAL IGL	490.2	21	1576.4	10	8.4	NM	19.9	NM	1.7	NM	1.2	NM	0.05
INTERNATIONAL FLAVORS & FRAGRANCES IFF	462.8	0	1385.0	-3	49.6	48	136.9	58	10.7	7.3	28.9	19	1.74
LUBRIZOL LZ	510.3	10	1486.2	6	36.5	60	100.8	37	7.1	4.9	14.1	12	2.35

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LYONDELL CHEMICAL LYO	855.0	15	2372.0	-5	5.0	NM	-48.0	NM	0.6	NM	-12.5	NM	-0.80
MILLENNIUM CHEMICALS MCH	411.0	5	1167.0	-7	6.0	NM	-24.0	NM	1.5	NM	-3.0	NM	-0.25
MONSANTO MON	679.0	-27	3453.0	-19	-165.0	NM	68.0	-83	NM	NM	-0.7	NM	-0.14
OM GROUP OMG	1357.2	63	3807.7	196	-71.2	NM	-22.3	NM	NM	2.5	-0.3	NM	0.01
PPG INDUSTRIES PPG	2068.0	3	6077.0	-3	148.0	59	-154.0	NM	7.2	4.7	-2.6	NM	-0.42
PRAXAIR PX	1292.0	2	3831.0	-2	131.0	111	408.0	30	10.1	4.9	23.9	17	3.20
ROHM & HAAS ROH	1454.0	8	4292.0	-1	77.0	45	254.0	NM	5.3	3.9	9.0	25	1.32
RPM INTERNATIONAL RPM ⁽⁷⁾	542.4	2	1507.4	1	44.2	21	84.7	57	8.1	6.9	12.3	15	0.98
SCHULMAN (A.) SHLM ⁽⁴⁾	255.3	12	728.4	1	10.8	96	26.9	101	4.2	2.4	9.5	16	1.08
SIGMA-ALORICH SIAL	304.8	12	910.7	9	40.3	9	125.8	8	13.2	13.6	18.8	21	2.16
SOLUTIA SOI	718.0	4	2108.0	-3	0.0	NM	37.0	-12	0.0	1.0	NM	NM	-0.62
TERRA INDUSTRIES TRA	257.9	9	770.7	-4	-1.9	NM	-19.5	NM	NM	NM	-15.4	NM	-0.60
VALSPAR VAL ⁽²⁾	575.0	6	1560.1	12	38.1	49	85.2	74	6.6	4.7	12.1	24	1.71
(B) CONSTRUCTION MATERIALS													
INDUSTRY COMPOSITE	2223.8	-5	5547.9	-4	223.6	-2	383.9	18	10.1	9.8	11.6	12	2.66
LAFARGE NORTH AMERICA LAF	1099.0	-4	2440.4	-3	142.9	9	196.5	29	13.0	11.5	13.2	8	3.78
TEXAS INDUSTRIES TXI ⁽⁷⁾	339.0**	-6	986.8	4	3.9	-22	33.6	NM	1.2	1.4	6.6	11	2.25
VULCAN MATERIALS VMC	785.8	-7	2120.6	-7	76.8	-17	153.8	-13	9.8	10.9	11.8	17	1.94
(C) CONTAINERS & PACKAGING													
INDUSTRY COMPOSITE	12598.3	4	35719.3	1	533.1	27	989.0	-2	4.2	3.5	1.9	NM	0.11
APTARGROUP ATR	239.8	8	691.6	1	17.8	13	48.6	-1	7.4	7.1	10.6	17	1.60
BALL BLL	1038.6	4	2948.7	4	50.0	38	127.4	NM	4.8	3.6	25.0	21	2.36
BEMIS BMS	601.0	4	1738.5	0	43.3	20	122.2	21	7.2	6.3	16.6	17	3.01
CROWN CORK & SEAL CCK	1892.0	-5	5248.0	-5	68.0	NM	53.0	NM	3.6	NM	NM	NM	-6.91
GRAPHIC PACKAGING INTERNATIONAL GPK	270.0	0	797.6	-5	0.9	-42	8.7	-4	0.4	0.6	-1.8	NM	-0.12
GREIF BROS. GEF ⁽²⁾	435.1	0	1197.3	18	8.0	-38	18.7	-75	1.8	3.0	5.7	17	1.47
OWENS-ILLINOIS OI	1472.1	8	4280.3	6	97.9	41	-43.8	NM	6.7	5.1	-6.3	NM	-0.48
PACKAGING CORP. OF AMERICA PKG	455.6	0	1317.7	-4	14.6	-50	35.8	-60	3.2	6.4	7.0	35	0.50
PACTIV PTV	727.0	5	2102.0	0	59.0	31	161.0	35	8.1	6.5	24.0	15	1.30
SEALED AIR SEE	825.8	8	2358.2	3	66.2	49	192.7	63	8.0	5.8	20.0	7	2.09
SILGAN HOLDINGS SLGN	640.9	8	1521.4	3	26.2	-4	48.2	30	4.1	4.6	75.3	6	2.88
SMURFIT-STONE CONTAINER SSCC	2106.0	2	6027.0	-4	37.0	32	70.0	13	1.8	1.4	3.2	41	0.32
SONOCO PRODUCTS SON	717.4	10	2084.0	8	29.2	-32	100.5	56	4.1	6.6	14.6	18	1.32
TEMPLE-INLAND TIN	1177.0	11	3407.0	7	15.0	-66	46.0	-46	1.3	4.2	3.5	29	1.43
(D) METALS & MINING													
INDUSTRY COMPOSITE	17478.8	10	50043.5	5	462.6	981	674.3	NM	2.6	0.3	-2.5	NM	-0.29
AK STEEL HOLDING AKS	1117.6	16	3226.8	11	16.7	NM	14.1	NM	1.5	NM	-6.3	NM	-0.60
ALCOA AA	5222.0	-5	15450.0	-13	193.0	-43	609.0	-42	3.7	6.2	4.4	40	0.55
ALLEGHENY TECHNOLOGIES ATI	469.3	-13	1453.6	-11	-7.5	NM	-26.1	NM	NM	1.5	-8.1	NM	-0.89
ARCH COAL ACI	399.5	14	1141.4	5	1.6	NM	-3.6	NM	0.4	NM	0.9	NM	0.09
BETHLEHEM STEEL BHMSQ	938.5	14	2675.8	2	-54.2	NM	-270.4	NM	NM	NM	NM	NM	-6.56
COMMERCIAL METALS CMC ⁽⁴⁾	672.6	NA	1881.9	NA	9.0	NA	31.7	NA	1.3	NA	8.1	11	1.43
COMMONWEALTH INDUSTRIES CMIN	253.9	2	727.5	2	6.1	NM	2.8	NM	2.4	NM	NM	NM	-10.91
CONSOL ENERGY CNX	546.4**	2	1629.0	-9	-7.0	NM	7.5	-95	NM	NM	8.9	50	0.26
FREEPORT-McMORAN COPPER & GOLO FCX	538.7	22	1339.4	-6	71.0	428	94.1	-11	13.2	3.0	NM	28	0.44
MASSEY ENERGY MEE	363.1**	14	1052.6	10	-1.1	NM	-19.5	NM	NM	NM	-1.4	NA	NA
NUCOR NUE	1165.6	11	3335.5	6	39.2	91	119.2	38	3.4	1.9	6.4	23	1.86
PEABODY ENERGY PTU	714.6**	9	2047.3	NA	29.0	607	75.8	NA	4.1	0.6	7.4	17	1.51
PHELPS DODGE PD	941.2	0	2826.5	-9	-29.3	NM	-70.5	NM	NM	NM	-5.0	NM	-1.91
QUANEX NX ⁽²⁾	266.9	8	720.6	8	24.3	153	40.4	125	9.1	3.9	12.8	11	3.32
ROUGE INDUSTRIES ROU	303.5	40	841.7	20	5.3	NM	-45.0	NM	1.7	NM	-47.0	NM	-2.65
RYERSON TULL RT	533.3	-2	1598.5	-9	2.6	NM	-6.7	NM	0.5	NM	-11.4	NM	-2.10
STEEL DYNAMICS STLD	240.7	53	621.3	33	29.1	NM	50.5	497	12.1	1.4	9.2	14	0.94
UNITED STATES STEEL X	1905.0	16	5097.0	4	106.0	NM	50.0	NM	5.6	NM	-4.6	NM	-1.43
USEC USU ⁽⁶⁾	360.8	20	926.4	12	1.2	NM	12.6	-74	0.3	NM	2.3	25	0.27
WORTHINGTON INDUSTRIES WOR ⁽⁷⁾	525.5	28	1450.5	12	27.5	92	8.4	-73	5.2	3.5	3.2	82	0.23
(E) PAPER & FOREST PRODUCTS													
INDUSTRY COMPOSITE	23385.1	9	67629.8	4	248.4	NM	546.2	NM	1.1	NM	-1.1	NM	-0.22
BOISE CASCADE BCC	1935.2	3	5611.5	-1	8.5	-43	5.1	NM	0.4	0.8	-3.4	NM	-0.86
BOWATER BOW	643.8	15	1914.8	9	-32.3	NM	-75.8	NM	NM	NM	-3.0	NM	-1.01
GEORGIA-PACIFIC GP	6152.0	-2	18170.0	-5	66.0	NM	44.0	NM	1.1	NM	-3.3	NM	-0.63
INTERNATIONAL PAPER IP	6343.0	-3	18686.0	-7	145.0	NM	425.0	NM	2.3	NM	-1.4	NM	-0.31
LOUISIANA-PACIFIC LPX	501.8	0	1502.1	2	18.4	338	26.9	NM	3.7	0.8	-4.1	NM	-0.42
MEADOWS WOODS MWV	2029.0	105	5355.0	81	17.0	-43	-44.0	NM	0.8	3.0	-0.9	NA	NA
POTLATCH PCH	324.1	-4	975.4	-1	-10.4	NM	-31.9	NM	NM	NM	-12.7	NM	-2.24
RAYONIER RYN	293.1	11	831.1	-4	15.6	160	42.1	-15	5.3	2.3	6.8	24	1.77
WAUSAU-MOSINEE PAPER WMO	251.1	2	714.9	-1	7.6	5	16.7	301	3.0	3.0	5.7	22	0.43
WEYERHAEUSER WY	4912.0	31	13869.0	24	13.0	-86	138.0	-63	0.3	2.4	1.9	82	0.55

CORPORATE SCOREBOARD

COMPANY SYMBOL	SALES				PROFITS				MARGINS		RETURN ON COMMON EQUITY 12 MONTHS ENDING 9-30	PRICE-EARNINGS RATIO 10-31	12 MONTHS' EARNINGS PER SHARE
	3RD QUARTER 2002 \$ MIL.	CHANGE FROM 2001 %	9 MONTHS 2002 \$ MIL.	CHANGE FROM 2001 %	3RD QUARTER 2002 \$ MIL.	CHANGE FROM 2001 %	9 MONTHS 2002 \$ MIL.	CHANGE FROM 2001 %	3RD QUARTER 2002 %	3RD QUARTER 2001 %			
TELECOMMUNICATION SERVICES SECTOR													
SECTOR COMPOSITE	68409.0	0	201738.7	-1	5517.8	464	-8118.8	NM	8.1	1.4	-8.2	NM	-0.84
22 TELECOMMUNICATION SERVICES													
INDUSTRY GROUP COMPOSITE	68409.0	0	201738.7	-1	5517.8	464	-8118.8	NM	8.1	1.4	-8.2	NM	-0.84
(A) DIVERSIFIED TELECOMMUNICATION SERVICES													
INDUSTRY COMPOSITE	57510.6	-3	170947.1	-4	7198.2	522	-4645.4	NM	12.5	1.9	-6.0	NM	-0.72
ALLTEL AT	2082.5	11	5839.8	4	237.8	7	667.7	-18	11.4	11.8	15.4	17	2.88
AT&T T	11956.0	-8	36044.0	-9	207.0	NM	-12702.0	NM	1.7	NM	-32.9	NM	-3.84
BELLSOUTH BLS	5542.0	-8	17019.0	1	733.0	NM	2181.0	23	13.2	0.1	17.0	17	1.58
BROADWING BRW	562.9	-3	1652.8	-4	4.0	NM	-47.8	NM	0.7	NM	NM	NM	-1.17
CENTURYTEL CTL	524.5	24	1386.1	11	63.6	7	146.7	36	12.1	14.1	8.0	21	1.38
IOT IDT (5)	416.7	26	1192.4	25	-78.2	NM	-145.0	NM	NM	NM	-18.0	NM	-2.08
LEVEL 3 COMMUNICATIONS LVL	1067.0	187	2203.0	83	-304.0	NM	-756.0	NM	NM	NM	NM	NM	-11.59
QWEST COMMUNICATIONS INTERNATIONAL Q	3797.0	-13	11755.0	-15	-327.0	NM	-2403.0	NM	NM	NM	-7.8	NM	-1.75
SBC COMMUNICATIONS SBC	10556.0	-7	31921.0	-6	1770.0	-15	5325.0	-11	16.8	18.3	20.3	13	1.96
SPRINT FON GROUP FON	3805.0	-7	11523.0	-8	484.0	317	794.0	23	12.7	2.8	-0.9	NM	-0.13
VERIZON COMMUNICATIONS VZ	17201.0	1	50411.0	0	4408.0	134	2294.0	-12	25.6	11.1	0.8	NM	0.09
(B) WIRELESS TELECOMMUNICATION SERVICES													
INDUSTRY COMPOSITE	10898.5	19	30791.6	21	-1680.3	NM	-3473.3	NM	NM	NM	-24.0	NM	-1.21
AT&T WIRELESS SERVICES AWE	4063.0	16	11584.0	15	-2049.0	NM	-2074.0	NM	NM	4.5	-12.3	NM	-0.91
NEXTEL COMMUNICATIONS NXTL	2279.0	26	6390.0	25	383.0	NM	-85.0	NM	16.8	NM	NM	NM	-2.03
SPRINT PCS GROUP PCS	3157.0	19	9023.0	30	-7.0	NM	-323.0	NM	NM	NM	-87.6	NM	-0.65
TELEPHONE & DATA SYSTEMS TDS	801.9	19	2190.9	14	-19.5	NM	-958.3	NM	NM	7.6	-30.7	NM	-14.89
U.S. CELLULAR USM	597.6	19	1603.7	13	12.2	-77	-33.0	NM	2.0	10.6	0.0	NM	0.00
UTILITIES SECTOR													
SECTOR COMPOSITE	76006.8	8	202375.2	-6	5074.0	-34	13778.5	-21	6.7	11.0	10.5	13	1.92
23 UTILITIES													
INDUSTRY GROUP COMPOSITE	76006.8	8	202375.2	-6	5074.0	-34	13778.5	-21	6.7	11.0	10.5	13	1.92
(A) ELECTRIC UTILITIES													
INDUSTRY COMPOSITE	54626.6	7	143596.9	-3	5664.4	-9	12038.0	-2	10.4	12.2	12.3	12	2.55
ALLETE ALE	382.4	2	1111.4	1	38.3	8	105.7	0	10.0	9.4	10.5	14	1.58
ALLIANT ENERGY LNT	724.9	10	1936.1	-8	46.3	-35	65.8	-51	6.4	10.8	6.4	12	1.34
AMEREN AEE	1232.0	-13	3338.0	-5	243.0	-10	423.0	-3	19.7	19.0	11.4	13	3.22
AMERICAN ELECTRIC POWER AEP	3900.0	5	10800.0	6	427.7	6	684.0	-28	11.0	10.9	8.2	12	2.06
CENTERPOINT ENERGY CNP	1922.9	-16	5805.6	-33	161.5	-12	394.3	-8	8.4	8.0	9.2	NA	NA
CINERGY CIN	1098.2	6	2985.6	-3	131.4	2	273.9	-18	12.0	12.5	11.7	14	2.30
CONSOLIDATED EDISON ED	2510.0	4	6404.8	-15	286.5	2	557.5	-2	11.4	10.7	11.7	13	3.16
CONSTELLATION ENERGY GROUP CEG	1270.3	22	3331.1	11	154.0	-8	470.5	34	12.1	16.0	5.1	21	1.22
DOMINION RESOURCES D	2597.0	2	7563.0	-6	430.0	25	1024.0	55	16.6	13.5	10.4	15	3.26
DPL DPL	344.7	-3	901.7	-4	64.7	-23	61.9	-66	18.8	23.6	9.5	22	0.64
EDISON INTERNATIONAL EIX	3997.0	3	9510.0	12	355.0	-56	1112.0	350	8.9	20.8	79.0	1	10.00
ENTERGY ETR	2468.9	-4	6426.3	-15	366.8	16	541.4	-25	14.9	12.3	6.8	19	2.29
EXELON EXC	4370.0	4	11245.0	-3	551.0	47	1273.0	18	12.6	9.0	18.9	10	4.98
FIRSTENERGY FE	3572.3	83	9323.2	62	324.5	29	691.8	29	9.1	12.8	10.5	12	2.78
FPL GROUP FPL	2353.0	-6	6251.0	-4	153.0	-55	358.0	-47	6.5	13.6	10.9	22	2.70
HAWAIIAN ELECTRIC INDUSTRIES HE	431.6	-4	1218.0	-7	33.3	14	92.2	10	7.7	6.5	11.6	15	3.22
NORTHEAST UTILITIES NU	1361.0	-11	3770.1	-19	50.0	40	100.2	-55	3.7	2.3	6.7	13	1.12
NSTAR NST	701.0	21	2024.3	-19	73.7	7	114.2	NM	10.5	7.7	11.3	16	2.64
PEPCO HOLDINGS POM	1641.2	128	2716.7	42	116.5	66	187.9	2	7.1	9.7	9.1	15	1.38
PINNACLE WEST CAPITAL PNW	873.0	-25	1992.8	-31	100.9	-38	230.0	-21	11.6	14.0	10.3	9	3.13
PPL PPL	1728.0	41	4055.0	7	137.0	-18	289.0	-45	7.9	13.7	-3.3	NM	-1.48
PROGRESS ENERGY PGN	2352.5	1	6279.1	-4	151.9	-59	405.1	-36	6.5	15.7	5.0	29	1.46
PUBLIC SERVICE ENTERPRISE GROUP PEG	2327.0	44	5690.0	7	207.0	18	161.0	-72	8.9	10.8	9.6	17	1.73
PUGET ENERGY PSD	458.5	-4	1738.4	-21	8.5	25	66.4	-41	1.9	1.4	4.8	28	0.77
SOUTHERN SO	3248.0	3	8092.0	1	595.0	7	1151.0	15	18.3	17.5	15.3	17	1.78
TECO ENERGY TE	731.0	11	2015.3	5	112.8	24	263.6	23	15.4	13.8	14.4	7	2.23
TXU TXU	4276.0	8	11925.0	-4	216.0	-37	696.0	-8	5.1	8.6	8.7	5	2.77
UIL HOLDINGS UIL	321.1	2	863.7	6	21.8	-13	40.5	-18	6.8	7.9	10.0	9	3.51
UNISOURCE ENERGY UNS	258.5	-38	656.9	-40	22.8	47	28.4	-40	8.8	3.7	9.9	13	1.23
WISCONSIN ENERGY WEC	869.8	5	2726.7	-10	52.1	9	93.3	-46	6.0	5.8	6.3	21	1.12
WPS RESOURCES WPS	304.8	17	900.1	2	31.3	38	82.5	39	10.3	8.7	13.2	12	3.22

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CORPORATE SCOREBOARD

COMPANY SYMBOL	SALES				PROFITS				MARGINS		RETURN ON COMMON EQUITY 12 MONTHS ENDING 9-30	PRICE-EARNINGS RATIO 10-31	12 MONTHS' EARNINGS PER SHARE
	3RD QUARTER 2002 \$ MIL	CHANGE FROM 2001 %	9 MONTHS 2002 \$ MIL	CHANGE FROM 2001 %	3RD QUARTER 2002 \$ MIL	CHANGE FROM 2001 %	9 MONTHS 2002 \$ MIL	CHANGE FROM 2001 %	3RD QUARTER 2002 %	3RD QUARTER 2001 %			
(B) GAS UTILITIES													
INDUSTRY COMPOSITE	4140.6	1	14888.4	-25	214.5	178	1128.2	26	5.2	1.9	13.5	11	2.23
KEYSPAN KSE	1079.8	-2	4167.1	-17	5.0	NM	248.8	41	0.5	NM	10.4	17	2.19
NEW JERSEY RESOURCES NJR (3)	466.8	103	1434.9	4	-2.5	NM	37.2	7	NM	NM	15.3	15	2.09
NICOR GAS	249.8	15	1187.6	-39	30.0	-9	85.8	-13	12.0	15.2	18.1	11	2.94
NISOURCE NI	960.1	-15	3760.8	-25	25.1	NM	291.5	91	2.6	NM	9.8	10	1.68
SEMPRA ENERGY SRE	1384.0	-2	4338.0	-33	157.0	52	465.0	8	11.3	7.3	20.5	8	2.67
(C) MULTI-UTILITIES & UNREGULATED POWER													
INDUSTRY COMPOSITE	16756.2	16	42597.7	-7	-860.1	NM	475.3	-88	NM	9.2	3.2	27	0.44
AES AES	2138.0	16	6498.0	12	-99.0	NM	-24.0	NM	NM	0.3	6.8	5	0.33
DUKE ENERGY DUK	4213.0	-12	11497.0	-23	230.0	-71	1086.0	-39	5.5	16.6	9.2	13	1.59
DYNEGY DYN	1713.0	-25	4746.0	-35	-1246.0	NM	-1496.0	NM	NM	12.5	-52.7	NM	-3.95
ENERGY EAST EAS	1016.2	27	2759.6	-5	23.7	NM	134.6	13	2.3	NM	8.2	13	1.62
MDU RESOURCES GROUP MDU	612.4	11	1474.6	-15	53.9	6	102.5	-19	8.8	9.2	11.2	13	1.86
NATIONAL FUEL GAS NFG (3)	244.6	-2	1070.4	-29	4.9	NM	84.5	575	2.0	NM	11.7	14	1.46
ONEOK OKE	465.4	22	1548.7	3	20.7	10	128.7	18	4.5	4.9	6.4	19	1.01
RELIANT RESOURCES RRI	5355.2	118	9511.9	68	57.7	-73	333.1	-36	1.1	8.7	5.6	2	1.25
SCANA SCG	694.0	-2	2165.0	-22	80.0	23	52.0	-90	11.5	9.2	2.7	52	0.56
VECTREN VVC	304.4	-15	1326.5	-21	14.0	192	73.9	107	4.6	1.3	12.2	16	1.57
(D) WATER UTILITIES													
INDUSTRY COMPOSITE	483.5	22	1292.2	20	55.2	-1	137.1	7	11.4	14.1	9.5	26	1.69
AMERICAN WATER WORKS AWK	483.5	22	1292.2	20	55.2	-1	137.1	7	11.4	14.1	9.5	26	1.69

ALPHABETICAL LIST OF COMPANIES

The number following each company name identifies the Scoreboard category under which it is listed

A

Abbott Laboratories 15b
Abercrombie & Fitch 5d
ABM Industries 17
Accenture 19b
Acuity Brands 16d
Adobe Systems 19c
Advanced Micro 20e
AdvancePCS 14b
ADVO 4
AES 23c
Aetna 14b
Affiliated Computer Svcs. 19b
AFLAC 12
AGCO 16f
Agere Systems 20e
Agilent Technologies 20c
Air Products & Chemicals 21a
Airborne 18a
Airgas 21a
AK Steel Holding 21d
Alaska Air Group 18b
Albemarle 21a
Alberto-Culver 8b
Albertson's 6
Alcoa 21d
Alexander & Baldwin 18c
Allegheny Tech. 21d
Allergan 15b
Allstate 23a
Alliant Energy 23a
Allied Waste Inds. 17
Allstate 12
Alltel 22a
Alpharma 15b
Amazon.com 5b
AMC Entertainment 4
Amerada Hess 9b
Ameren 23a
America West Holdings 18b
American Axle & Mfg. 1a
American Eagle Outfitters 5d
American Electric 23a
American Express 11
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American Power 16d
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B

AmeriCredit 11
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Ametek 16d
Amgen 15a
Amkor Technology 20e
Amphenol 20c
AMR 18b
AmSouth Bancorporation 10
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Analog Devices 20e
Andrew 20a
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AptarGroup 21c
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Arch Coal 21d
Archer Daniels 7b
Argosy Gaming 3
Arkansas Best 18d
Arrow Electronics 20c
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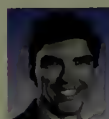
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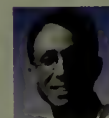
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LABOR CHIEFTANS' SECRET STOCK DEAL

Investigations may soon blow the lid off shenanigans at ULLICO, *BusinessWeek* has learned



BUDDIES: If McCarron is tarnished, Bush's bid to divide labor may falter

Just when it seemed as if the corporate crime wave was over, the messy stock scandal involving union-owned insurer ULLICO Inc. and bankrupt telecom Global Crossing Ltd. is about to burst into the open again. At the worst, indictments will be handed down against union bosses. At the least, the reputation of the U.S. labor movement will be sullied. And the scandal could complicate the Bush Administration's efforts to cultivate friendly unions.

Labor leaders are battling each other over how to handle the new imbroglio, which centers on ULLICO, parent of Union Labor Life Insurance Co. Some of the two dozen union leaders who sit on the insurer's board reaped hundreds of thousands of dollars by buying and selling privately traded shares in ULLICO, which earned some \$335 million from a \$7.6 million investment in Global Crossing before its initial public offering. Started in 1997 by Gary Winnick, Glob-

al had a market cap of more than \$20 billion at its 1999 peak. It filed for Chapter 11 in January, and its stock—once as high as 64—now trades for pennies.

When news of the union leaders' gains emerged last spring, embarrassed AFL-CIO President John J. Sweeney—who is a ULLICO director—insisted that the insurer conduct an internal investigation. Directors agreed to hire former Illinois Governor James R. Thompson, whose 70-page report is scheduled to be presented to them at a Nov. 20 meeting. But Sweeney and ULLICO CEO Robert A. Georgine have exchanged heated letters over the company's efforts to keep a lid on the report. At a Sept. 11 gathering, ULLICO directors agreed that they could read

the report but not take home copies—or even make notes. ULLICO shareholders—i.e., the union pension funds—won't even get a peek.

Georgine's goal, say lawyers and others involved, is to maintain attorney-client privilege over the report and prevent it from reaching the U.S. Attorney for the District of Columbia, who subpoenaed several ULLICO officials last spring and, *BusinessWeek* has learned, recently requested interviews with ULLICO directors. "The grand jury went to look at ULLICO, and it just keeps going on and on," says Channing D. Phillips, a spokesman for the U.S. Attorney's office.

Indeed, lawyers for some union leaders say they're expecting indictments of numerous ULLICO board members. Thompson's report could speed the process since it's likely to lay out details of the stock transactions that raise troubling legal questions, according to those familiar with his questioning of ULLICO directors. Both Sweeney and ULLICO officials declined comment, though some lawyers and union officials involved say they see no legal problems.

Even if no charges are filed, the episode is likely to damage labor. Besides stoking rank-and-file anger, the gory details of union leaders enriching themselves through pension-fund investments could undermine AFL-CIO efforts to capitalize on corporate scandals and force shareholder reforms.

That's a key reason why Sweeney, who made no profits from ULLICO stock, is taking a hard line. Indeed, AFL-CIO officials have talked privately of union leaders returning their ULLICO profits—an outcome that is now more likely since United Brotherhood of Carpenters President Douglas J. McCarron said on Oct. 29 that he will do just that. Sweeney, however, is con-

The pension funds that are ULLICO's shareholders weren't offered—or told about—the stock package directors got



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strained in how far he can go. Many union leaders on ULLICO's board—half of whom are retired—so far seem to be siding with Georgine. In addition, many are from building-trade unions, an AFL-CIO faction Georgine headed for many years. If they got together with allies such as Teamsters President James P. Hoffa, the construction unions could muster enough votes to replace Sweeney as AFL-CIO president. "Sweeney should worry about the building-trades unions. They're not on his side here," warns one official sympathetic to Georgine.

One positive side effect for Sweeney: The scandal could damage McCarron, who stood to make as much as \$400,000 from his ULLICO shares. McCarron has

been a thorn in Sweeney's side since he yanked the Carpenters out of the AFL-CIO last year. McCarron also has upset the AFL's political strategy by cozying up to the White House. If McCarron is tarnished, he can make less trouble for Sweeney—and Bush's ability to divide labor will be diminished.

One critical issue Thompson is likely to address goes to the heart of the ULLICO directors' legal defense. They argue—and outside legal experts largely agree—that they didn't breach their fiduciary duties to the pension funds by reaping more profits from ULLICO stock than the funds did. That's because the funds hire qualified

professional asset managers, called QPAMS, to make investment decisions including those involving ULLICO shares. So QPAMS, not labor leaders, have direct fiduciary responsibility to the funds.

Union leaders also point out that the stock plan was devised by Credit Suisse First Boston and blessed by lawyers. "We received assurances of the legality of the stock-repurchase program from ULLICO's legal counsel, investment advisors, accountants, and auditors," McCarron wrote in an Oct. 29 letter to Georgine.

Problem is, ULLICO took some key actions outside of that program. On Dec. 17, 1999, for

making ULLICO worth much more year-end, ULLICO shares are repriced at \$146. The union pension funds then own almost all of ULLICO—and the

money managers that run them—aren't told about Georgine offer.

LABOR'S STOCK SCANDAL GETS MESSIER

Some two dozen labor leaders sit on the board of ULLICO, a private life insurer owned by unions. Many personally profited when ULLICO earned \$335 million on Global Crossing. Here's how:

1997 ULLICO invests \$7.6 million in Global Crossing for a 7.7% stake.



GEORGINE

FALL, 1999 ULLICO CEO Robert Georgine secretly offers each director the chance to buy 4,000



GLOBAL CROSSING HEADQUARTERS

ULLICO shares at \$54—even though insiders know that Global's soaring value is



example, Georgine sent a letter to his directors offering each of them the right to purchase 4,000 ULLICO shares at \$53.94 a share. He did so even though ULLICO knew its shares would be reassessed at \$146 two weeks later, to reflect the company's investment in the then-booming Global Crossing.

The grand jury has been told that the QPAMS had no knowledge of this offer, *BusinessWeek* has learned. Nor were the QPAMS given a similar opportunity to buy cheap shares for the pension funds on whose behalf they act. If Thompson's report isn't covered by attorney-client privilege, it could help the U.S. Attorney to learn who knew what when Georgine's letter was sent out.

Union leaders "have no QPAM defense on the letter," says one insider.

Georgine also may want to bury the report by Thompson, who has interviewed more than 50 people and examined some 50,000 documents, because of what it's likely to say about his own stock deals. At the end of 1999, Georgine owned 52,868 shares of ULLICO, according to the company's proxy. But he bought many of them with an interest-free loan from ULLICO, say those with knowledge of the transaction. So he stood to make millions off his shares. It's not clear if this raises legal problems, but even his supporters concede that he's likely to take heat from the labor movement if word gets out.

Georgine also could have a difficult time returning such a large sum, as McCarron has offered to do. "McCarron's action puts disgorgement squarely on the table, which is where this is headed," says one union leader's lawyer.

If ULLICO directors do decide to return their stock profits, it may help to insulate them from the grand jury. After all, it would be tougher to convict anyone of improperly taking money they voluntarily gave back. Of course, disgorgement would also be a public admission that they shouldn't have taken the money in the first place. Either way, labor's image will be tarnished.

By Aaron Bernstein, with Paula Dwyer, in Washington

DECEMBER, 2000-

WINTER, 2001 ULLICO bought back shares at \$146, though its now-declining investment makes the value closer to \$75. Investors can sell as many as 4,000 shares, allowing them to personally reap profits from the investment than the

union pension funds did.

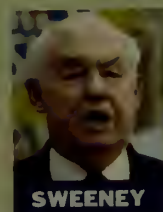
SPRING, 2002 The news breaks that ULLICO's directors, some of whom are trustees of their union's pension funds, made money on the Global investment while the pension funds suffered. A grand jury subpoenas officials at

ULLICO. The company then brings in former Illinois Governor Jim Thompson to conduct an internal investigation.

FALL, 2002

Georgine and AFL-CIO President John Sweeney—a ULLICO director

who didn't profit from the stock deal—battle over ULLICO's efforts to keep a lid on the upcoming Thompson report. One of ULLICO's concerns: The U.S. Attorney's office has issued new requests to interview ULLICO directors.



SWEENEY

Data: BusinessWeek

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A NEW CABLE C



ANT

**Cable chief
Stephen Burke will
team up with scion
Brian Roberts to
get the empire up
and running**



You would never know that Brian L. Roberts was about to be catapulted into the media elite. In mid-November, his company, cable operator Comcast Corp., is expected to close its \$54 billion acquisition of AT&T Broadband, the biggest deal in the industry since the AOL Time Warner merger in 2001. But on this evening in early October, Roberts, all 6 feet, 2 inches of him, is in a decidedly unglamorous position: He's scrunched into the back of a Ford Econoline van, barreling back to Philadelphia after a long day of volunteer work on behalf of his company. The 43-year-old executive, in jeans and a black Comcast T-

shirt a size too large, is literally on the edge of his seat as his teenage daughter dozes beside him. Several executives are nodding off as well. But Roberts is a live wire as he recounts his decision to bid for AT&T's huge cable business. "You only get one chance to redefine your company, and this was ours," he says.

Roberts practically grew up in the cable business (his father, Ralph, founded Comcast in 1963) and has a reputation as one of the best operators and toughest negotiators around, but he has never faced a challenge like this. In fact, no one in the industry has. Roberts' new company, AT&T Comcast Corp., will be unprecedented in size and influence. Before the merger, he could count a respectable 8.5 million customers in four major cities. Now, 21 million customers in 17 of the top 20 cities will be hooked up to his systems. That's nearly twice as many as the next biggest operator, Time Warner Cable. Put another way, it's in one of every five homes in America that has a television. AT&T Comcast could bring in some \$24 billion in 2003, more than Time Warner and Charter Communications combined.

Indeed, everything is increasing exponentially for Roberts. The company will have to handle nearly four times as many customer-service calls this year as Comcast did last year. The number of people working for him will just about triple, to more than 55,000. AT&T Comcast's debt will be a nation-size \$30 billion. And this is an executive who does not like to travel so far that he can't return home at night to see his kids. Up until two years ago, he still held Comcast's annual meeting in the lunchroom.

Even more daunting for Roberts is that AT&T Comcast will be so big that it is certain to shift the dynamic of power in the media business. Roberts, who likes to say his favorite TV show is the midnight special on his own QVC shopping channel, will effectively be the nation's top entertainment gatekeeper. Think about it: Nobody will have more control over which TV channels, Internet services, and movies are piped into U.S. homes—not News Corp.'s Rupert Murdoch, not Sumner Redstone at Viacom Inc.

Right from the start, Roberts will have the clout to do what cable executives have wanted to do for years: dictate what shows will reach a mass audience and at what price. One crucial issue for cable operators, for example, is the cost of programming, their single largest expense. For years, content-driven companies such as Walt Disney, News Corp., and Viacom have had the upper hand. That's about to change. Roberts, with his vast system, can now hold out for better terms, and other cable operators will ultimately benefit, too. Consumer advocates, though, worry about how thoroughly Roberts will dominate the industry. "AT&T Comcast will be the single most powerful media company in the U.S.," says Jeffrey Chester, executive director of the Center for Digital Democracy, a public-interest group that is a staunch critic of the Comcast-AT&T deal. "They will most certainly determine everyone's digital destiny."

The lanky Philadelphia native may not have been plotting to control cable, but he has methodically assembled the pieces of what could one day be a full-fledged media enterprise. He now has the cable subscribers. And to many people's surprise, he could be on his way to getting a critical mass of broadband users—a total of 342,000 new subscribers signed up at both AT&T and Comcast in the third quarter. Over the years, Roberts has accumulated a modest programming collection, too. He

Cover Story

*AT&T Comcast will
be unprecedented in
size and influence
—but must win
over skeptical
investors and sell
unproven services*

THE CABLE INDUSTRY BY THE NUMBERS

AT&T Comcast will post the highest earnings in the industry—and carry the most debt

*Cable businesses only
Data: National Cable Television Assn., company reports, Merrill Lynch & Co., Morgan Stanley

OPERATOR / TOP MARKETS	NUMBER OF BASIC SUBSCRIBERS (IN MILLIONS)	2003 ESTIMATES			
		REVENUE (IN BILLIONS)	EBITDA (IN BILLIONS)	DIGITAL SUBS	HIGH-SPEED DATA SUBS
AT&T COMCAST Baltimore, Boston, Chicago, D.C. area, Philadelphia, San Francisco, Seattle	21.0	\$18.2	\$6.6	7.8 mil	4.7
TIME WARNER Austin, Honolulu, Houston, New York, San Antonio, Tampa Bay	10.9	8.0	3.2	4.6 mil	3.6
CHARTER Los Angeles, St. Louis, South Carolina	6.6	5.0	2.0	3.1 mil	1.9
COX Las Vegas, New Orleans, Phoenix, San Diego, Orange County (Calif.)	6.3	5.8	2.0	2.0 mil	1.8
ADELPHIA (in bankruptcy) Los Angeles, Florida, Virginia, New England	5.7	N/A	N/A	N/A	
CABLEVISION Long Island (N.Y.), Westchester County (N.Y.)	3.0	2.6	1.0	671,000	1

bought big stakes in several cable channels, including QVC Inc. and E! Entertainment Television, as well as two Philadelphia sports teams (not for vanity, either—the unassuming Roberts has only met the 76ers All-Star point guard Allen Iverson twice in six years).

Still, Roberts doesn't talk about transforming the industry; he won't even use the words "synergy" and "convergence." He's not much of a visionary and isn't even sure he needs to get mixed up in programming, a business that has brought grief to so many. "We don't have a clearly defined content strategy at this time," he says. His most cosmic pronouncement comes out like this: "We will go from a regional cable company to being a premiere provider of entertainment and communications services into people's homes."

Translated, that means AT&T Comcast could be the first company to make good on the long-awaited promise of broadband. Consumers are just beginning to experience the benefits—and, for now, are willing to pay the costs—of faster and continuous connections to the Internet. With 21 million potential customers, AT&T Comcast will have the scale to actually make money

selling all the services that can go with it, from streaming video to music to video games. If broadband still proves elusive, though, the company's prospects could be jeopardized.

Even if Roberts gets broadband right, he couldn't have picked a worse time to burst on the scene. Media and cable companies have crumbled all around him. Investigations into the accounting practices at several cable outfits have cast suspicion on the entire industry. Questions about the quality of earnings persist. And the fact that companies spent tens of billions of dollars to upgrade systems with relatively little to show for it after nearly a decade raises fears among some that cable might be the next telecom. Meanwhile, satellite services are proving to be formidable competitors to cable operators' de facto regional monopolies. Over the next five years, the number of satellite subscribers is expected to grow by 37%, to 26 million, while the number of households that receive cable, now 70 million, may not increase at all, according to PricewaterhouseCoopers. And the collapse in October of the proposed merger of satellite services DirecTV and the Dish Network seems to have only galvanized EchoStar Communications Corp. Chairman and CEO Charles W. Ergen to go after cable subscribers even more aggressively.

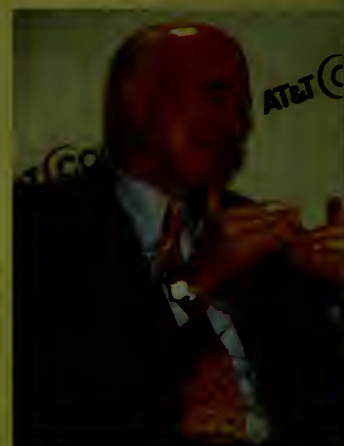
Any one of these problems would be worrisome enough. Together, they have led many investors to give up on the industry for now. Cable shares have lost 57% of their value in the past year, vs. a 15% decline for the Standard & Poor's

500-stock index. Comcast's shares alone have fallen nearly 34%, to about \$25, since it reached an agreement with AT&T last December. "Investors want to see the proof in the pudding. Where's the cash? It's that simple," says industry analyst Alan Bezoza of CIBC World Markets.

Roberts has even more to prove: From the start, AT&T Comcast will be shouldering its enormous debt in a weak

AT&T COMCAST: NOT JUST BROADBAND

Comcast's merger with AT&T Broadband will create a media giant with tremendous clout. Its holdings will include:



Will Armstrong be content in his role as nonexecutive chairman

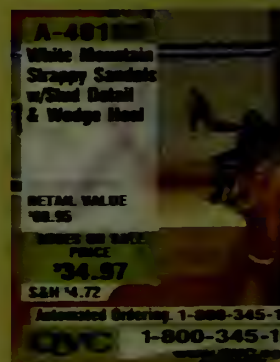
CABLE SYSTEMS \$18.2 Billion*

The largest U.S. cable system: 21 million subscribers, operating franchises in 8 of the top 10 cities. It has twice as many subscribers as the next-largest cable operator, Time Warner. At the end of 2002, it will have 6.6 million digital subscribers, 3.6 million high-speed data subscribers, and 1.5 million phone subscribers.

RETAIL \$5.1 Billion*

Owns 57% of shopping channel QVC. (John Malone's Liberty Media owns the rest.) On Dec. 2, 2001, it set a one-day record by taking \$80 million in orders for products that included 30,000 Dell computers.

Trinkets, baubles, and bangles have been golden for Roberts



*Estimated 2003 Revenues

Data: Merrill Lynch & Co.

CAPITAL SPENDING

\$5.5 bil

1.5 bil

1.3 bil

1.6 bil

N/A

780 mil

economy. Roberts will need to reassure impatient investors that he can pare it down and get cash flowing again. At the same time, to keep disgruntled AT&T customers from defecting, he has to spend about \$2 billion or so over the next two years to upgrade AT&T's poorly run cable systems, which turn in some of the lowest margins in the industry. There is also the tricky task of combining a regionalized cable company with a heavily centralized organization whose focus has been phone services. And Roberts will have to work with the man who initially and vehemently opposed the merger: Former AT&T Chief Executive C. Michael Armstrong, 64, who will become nonexecutive chairman of AT&T Comcast, could be a disruptive force at a difficult time, pushing for phone services over cable lines even though cable operators don't make

much money from that business right now. "I wonder [the Robertses] realize yet what a hornets' nest they bought," asks a cable executive familiar with the AT&T system.

As Roberts takes control of the biggest cable empire ever, he will rely on the two people he trusts

implicitly. The first is his 82-year-old father, Ralph. When they finally sealed the AT&T deal, after five long months of negotiations, Ralph walked his exhausted son to his room at the St. Regis Hotel in Manhattan. They had talked often about their dreams for the company, which Ralph built up from a single system in Tupelo, Miss. On this night, Ralph whispered to Brian as he embraced him: "This is a miracle." Roberts' other confidant is Stephen B. Burke, 44, whom he hired away from Walt Disney Co. four and a half years ago to run the cable division. Burke and Roberts share an easy camaraderie. They talk by phone half a dozen times a day and still high-five each other whenever the merger comes up, which is often. These men have proven to be a capable triumvirate; together, they run one of the few cable companies that has generated positive cash flow.

But the financial, management, and strategic challenges Roberts is now up against are immense. It's no surprise, of course, that his father thinks he will succeed: "It's not like AOL and Time Warner," says the elder Roberts. "We are in cable, and we bought cable." AOL Time Warner Vice-Chairman Ted Turner, who has known Roberts for 20 years (Roberts sat on the board of Turner Broadcasting System Inc. from 1989 to 1996), thinks he will, too: "I'll bet my last dollar on Brian Roberts." As for Roberts himself, he says with typical understatement: "The first 24 months

SPORTS

Revenue included in cable systems

% stake in Comcast
Acorn, which owns the
Philadelphia 76ers,
HL's Flyers, and the
Phantoms. Also
the Spectrum
First Union
arenas in
Philadelphia.

Allen Iverson
of the Sixers
and Roman
Cechmanek
of the Flyers
at work



CABLE CHANNELS

\$847 Million*

A 50% stake in E! Entertainment Television, which reaches 71 million homes, and Style; majority stake in the Golf Channel and the Outdoor Life Network. Also owns two sports channels, in the Baltimore/Washington region and in Philadelphia.

E!'s Anna
Nicole Smith
has the
channel's
top-rated
show



OTHER HOLDINGS

Estimated Value \$5 Billion

A 21% stake in Time Warner Cable, which is expected to be spun off. At that time, AT&T Comcast intends to cash out its shares, which have an estimated value of \$5 billion.

are all about execution."

He may be short on the vision thing, but Roberts has always had a head for figures. He used to drop in on his high school's financial adviser to chat and went on to study finance as an undergraduate at the University of Pennsylvania's Wharton School. For the next few years, he will be focused on just two numbers: \$30 billion in debt and 21 million subscribers. Back last December, many believed he had gotten carried away in the bidding war for AT&T Broadband. But Comcast's falling share price has had one benefit: Because Roberts negotiated an all-stock deal, his effective cost per subscriber has dropped from about \$4,500 to \$2,400. Still, AT&T Comcast will start out life with more debt than Time Warner and Charter combined. Although the company still maintains its investment-grade rating, \$30 billion doesn't sit easily with shareholders. "We're being tarred as a telecommunications company with

a lot of debt and overhang from the deal," says Burke. "We are just going to keep our heads down and deliver."

Almost from the moment he closed the deal, Roberts has been trying to figure out how to lessen his financial burden. He says he has a plan to decrease the debt by \$5 billion in the first year; most of the money will come from a masterful arrangement he recently struck with AOL Time Warner to unwind Time Warner Entertainment Co., a complex partnership between AT&T and AOL. Roberts seemed to get the better of the deal with CEO

Richard D. Parsons, who's supposedly the smoothest negotiator in the industry but who was also desperate to settle the issue. AT&T Comcast will receive \$2.1 billion in cash, \$1.5 billion in AOL stock, and a 21% stake in Time Warner Cable—which could be spun off by mid-2003. Comcast's stake is valued at about \$5 billion. The company will also sell stock in AT&T and Sprint PCS to raise cash. Lawrence J. Haverty Jr., senior vice-president of State Street Research & Management, a Comcast shareholder, says resolving the TWE matter "was absolutely terrific."

But Roberts is laboring under an entirely different set of expectations than he is used to. "There's a real show-me attitude now," he says. "Everything [the industry] says and does are dirty words." The fraud charges against the Rigas family, which ran Adelphia Communications Corp., and the Securities & Exchange Commission and Justice Dept. investigations at AOL Time Warner and

TROUBLE SIGNALS

Roberts and his executives face several challenges at a tough time for the industry

DIGEST AT&T

Need to complete the upgrade of AT&T's systems (only about 65% have been modernized) and boost some of the lowest margins in the industry, at around 25%, to Comcast averages of about 40% to 45%

REDUCE DEBT

Paring down a hefty debt of about \$30 billion in 2003 will require cashing out holdings in AOL, AT&T, and Sprint PCS

WIN BACK WALL STREET

Generating positive cash flow quickly will help regain the confidence of investors, who see big spending but no immediate growth from new services

RETAIN MARKET SHARE

Launching new products, such as video on demand, will help keep TV watchers hooked up to cable instead of running off to fast-growing satellite services, such as DirecTV and the Dish Network

Space invader: Satellites are snatching up viewers



Charter have made many deeply wary of cable companies. It doesn't help matters that no one in the industry reports real net earnings, that each company seems to have its own definition of capital spending, that they can't even agree on what constitutes a subscriber. What's not to be suspicious about?

These scandals come at an unfortunate time for Roberts. And the charge of self-dealing against the Rigases must be galling to someone who prefers Amtrak to limos and buys sandwiches at the food court near his office. The outward resemblances to Adelphia are especially awkward; it is, after all, a family-run cable operator in Pennsylvania founded by a shrewd patriarch.

But the Robertses don't hide the fact that they still regard Comcast as very much their company. Even Brian's mother, Suzanne, an actress, has a weekly half-hour show about "living well" that airs on a Comcast channel. Brian pestered

his father about joining the family business almost from the time he knew they had one. "When he was still in high school, I had him sit in the corner and watch me negotiate a loan with a banker. He was fascinated," says Ralph. Brian read *The Wall Street Journal* as a teenager—even invested in the stock market (and this was the 1970s). After college, in 1981, he started out as a controller in Comcast's Trenton office. By the age of 30, he was the company's president. At a recent industry dinner honoring Roberts, AOL Time Warner's Parsons said his ascension to the head of Comcast was his birthright: "The crown prince has assumed the throne." Then he joked that the *mohel* at Roberts' *bris* had used cable splicers. Roberts could only reply: "Geez, Dick, nice."

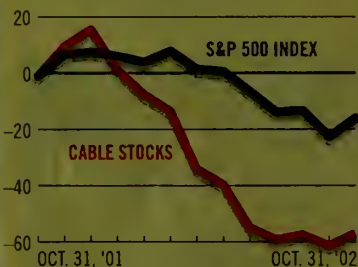
Now Roberts is trying to do what he can to set himself apart from his disgraced and disparaged colleagues. He worked closely with an industry task force that on Oct. 21 released a voluntary set of guidelines on how to report subscribers and capital costs, a framework meant to give more clarity to Wall Street. Comcast has also recently disclosed more information about its accounting practices, for the first time breaking down how it capitalizes expenditures.

Like all cable operators, though, Comcast reports EBITDA (earnings before interest, taxes, depreciation, and amortization), a metric that some investors say masks whether a company has real net earnings. Cable executives always argue that the more important measure is free cash flow; if so, then AT&T Comcast should start to show positive results of the merger in 2004, when it is expected to swing from negative \$300 million

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BAD RECEPTION

Accounting scandals and huge debt have led investors to steer clear of cable stocks



▲ PERCENT
Data: Bloomberg Financial Markets

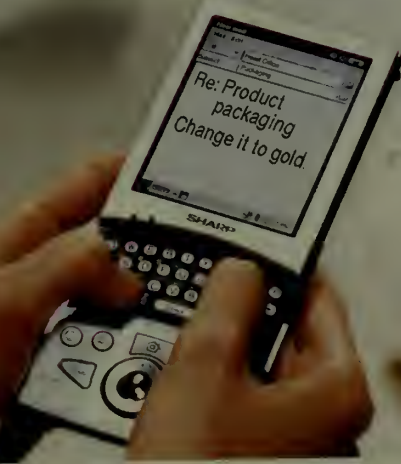
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\$2 billion in free cash flow. That will rise to \$5 billion in 2005, estimates Merrill Lynch & Co. Investors looking for real net earnings might be able to see those results as early as 2004, once the investments in upgrades begin to wane, predicts Goldman, Sachs & Co. analyst Richard Greenfield. Indeed, though many still believe the entire industry is in trouble, over the next two years the leading operators should emerge from their spending sprees with better prospects. "You'll see more and more companies beginning to deliver on these long-promised services," says media analyst Tom Wolzien at Sanford C. Bernstein Co.

Cover Story

not be too far away. They have always had a close partnership. Herbert Allen, the media power broker, once described it as "one of the most unusual relationships I've seen. I think they are equal in their respect for each other." At a time when some sons would be chafing under their father's watch, Brian still turns to Ralph for counsel. And at a time when some fathers would be heading for their vacation homes, Ralph will serve on AT&T Comcast's board and lead its executive committee. Ralph's and Brian's offices are next to each other, the doors always open. Brian can often be seen sitting across from his father's desk seeking advice. When asked why he didn't take off his jacket during a recent photo shoot, Brian said: "Oh, no. My father would have killed me."

Roberts hasn't had to hire many top executives—most have been at the company for years—but luring Burke away from Disney was a coup. Burke helped launch Disney's chain of stores and then fix the finances at the Paris theme park. Although Burke had no previous cable experience, he has quickly earned respect in the industry. "He's one of the best executives in media," says Jessica Reif Cohen of Merrill Lynch. Burke, who writes a dozen personal notes to rank-and-file workers each week, brings a certain polish and operational expertise to the company. As he says with the requisite modesty: "I take care of the plumbing here."

While Roberts is plenty collegial in the office, executives on the outside say he is easily the most competitive man they know. Several years ago at Allen's media conference in Sun Valley, Idaho, Roberts was desperate to persuade Warren E. Buffett to buy Comcast stock, but not desperate enough to pull back and let the Oracle of Omaha golf a better round. (Roberts is still trying to persuade Buffett to buy.) But Roberts seems comfortable sharing power with Burke; no doubt similar backgrounds make that easier. Brian grew up watching his father work hand-in-hand with Comcast co-founder Julian Brodsky, while Burke observed his father, Dan, president of the ABC Network, work closely with Capital Cities/ABC Chairman Tom Murphy.

Two years ago, Roberts saw the opportunity of a

As Roberts begins to redefine the company his father founded, Ralph will



Comcast founder
Ralph Roberts
—at age 82, still
a key player

lifetime when AT&T announced it would split itself in three. The phone giant's cable unit, AT&T Broadband, had more than 13 million subscribers, several prized systems—and some of the worst numbers in the business. Its margins were as low as 18% in some cities, vs. industry averages of 35% or better. The systems had been neglected for years, first by ex-Tele-Communications Inc. Chairman John C. Malone, and then by Armstrong at AT&T, who bought the systems from Malone in 1998 but stayed largely focused on telephony. While Comcast's systems are 95% upgraded, only 65% of AT&T's are. Since the deal was announced last December, AT&T has lost nearly 500,000 subscribers.

Burke says his immediate goal is improving margins to at least Comcast's average of 40% within three years. He'll decentralize operations (AT&T customer service had been handled out of its Denver headquarters), cut costs (Comcast has already said it will pare 1,700 of 4,000 jobs in Denver), improve customer service, and sell more premium-priced services such as

digital cable or high-speed data. "What is good is that we've done this before with other systems we've acquired," says Burke.

Central to AT&T Comcast's success is the complicated business of broadband. "That's our critical product of the future because we can add on other services," says Burke. Analysts predict that about 30% of AT&T Comcast's subscribers, or 6.7 million homes, will be paying for high-speed data by the end of 2006. If they are right, that revenue will go a long way toward meeting Burke's goal of boosting AT&T's yearly cash flow per subscriber from \$175 to a figure closer to Comcast's \$300 level. These services are also key to fending off the threat from satellite, which can't

YOUR DIGITAL FUTURE: IT WON'T BE CHEAP

AT&T Comcast's growth plan: sign up customers for an array of new high-priced services

BASIC CABLE SERVICE On average about **\$35 a month** for 60 to 70 channels

DIGITAL CABLE SERVICE On average an additional **\$10 a month**. The digital set-top box gives subscribers more than 250 channels, two-way interactivity, and a sharper picture.

HIGH-SPEED DATA SERVICE A cable-modem hookup and service cost **\$40 a month**, if you want just Comcast's broadband portal, or **\$55 a month** if you want Comcast's service along with America Online, which has more content.

VIDEO ON DEMAND Initially, the service will be rolled out to digital customers for **free**, allowing them access at any time to 750 hours of programming. For now, the idea is that the free service will drive digital sign-ups.

TOTAL ESTIMATED MONTHLY BILL: \$35-\$100

Data: Comcast Corp., Merrill Lynch & Co.

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There's talk of Roberts buying Disney someday, but right now he can't buy much of anything

offer such interactive products. Burke also is counting on selling more advertising; he believes digital technology will make cable a more interesting proposition, since marketers will be able to target spots to individual subscribers or homes. Advertising revenue will be \$1 billion next year, and Burke predicts that will double in five years.

Although AT&T is a much larger system to swallow than any Comcast has acquired in the past, few doubt that Roberts

and Burke can manage the integration. But their talk about digital cable service,

Cover Story

high-speed data, and video on demand as major sources of cash flow seems far too optimistic to many. Haven't cable executives been promising this for years? "I'd be shocked if you get 20% of homes on high-speed data," says Leo Hindery, an ex-president of AT&T Broadband and now CEO of the Yankees Entertainment & Sports Network LLC. Burke counters that Comcast now has an edge: A bonus from the TWE deal was a broadband-access pact it reached with AOL. Although the terms have not been disclosed, the arrangement is said to stipulate that AOL will pay Comcast about \$38 a month per new subscriber (consumers will pay about \$55 for AOL and Comcast broadband services combined), at the same time delivering to Comcast all those AOL customers.

Roberts made it clear early on that most of AT&T Broadband's senior executives would be better off elsewhere, and many already have left. One person who is staying, though, may be the most difficult—the former boss. Armstrong has been criticized for his role in running AT&T; he was pushed to sell the broadband unit by his board of directors. At AT&T Comcast, he finds himself in the undefined position of nonexecutive chairman, surrounded by Comcast veterans. It sounds like trouble already. One Comcast executive says: "This was a face-saving situation, and Mike knows that." At worst, he could be a disruptive force; at best, a distraction.

So far, the Roberts-Armstrong relationship has been "constructively awkward," says one executive. Armstrong and Roberts have talked over the past months, mostly by phone, but he has not been part of Roberts' inner circle planning for the new company. Armstrong hasn't been included in strategy sessions or the weekend conference calls Roberts holds from home. Nor has he been invited on the road trips to inspect AT&T cable systems. Clashes will likely arise over the telephony business: Roberts is uneasy about making a big push after so many others have tried and failed. "Mike is going to have to recognize this is a very different role for him," says AT&T Comcast director Felix Rohatyn, a former managing director at investment bank Lazard Frères. "He's going to have to accommodate himself to what Brian wants."

For his part, Armstrong says he sees his role as helping Roberts strengthen the company's financial position. But given the opportunity, Armstrong quickly shows why he may be more of a nuisance for Roberts. He still criticizes Brian and Ralph for taking 33% voting control in the new company (they had 86% voting control in Comcast, through a special class of stock). Armstrong says he urged them to take 20% particularly given the growing concerns about the concentration of power in the hands of a few shareholders. "This is a new company and an opportunity to do it right," he says. "If we paid a full and fair premium for the company, why should we give up control?" counters Roberts. "[Family control] has been good so far for shareholders," who have seen the stock split 12 times since 1971.

Roberts is as confident as the next CEO when it comes to his company's performance. But he's reluctant to talk about lofty goals. In fact, he says he has pretty much junked the notion for now. As he puts it: "I don't get to relish this deal.

have to deliver." But his hesitancy to articulate what the company will look like in five years makes some people nervous. "Brian has to figure out, and fast, if he wants to be predominantly a distribution company or run a content company, enhanced by distribution, like supermen Rupert Murdoch and

Mel Karmazin do," says Hindery. There is talk about Roberts buying Disney one day, though not a word from him. But who can blame Roberts for hanging back when so many media moguls with grand visions have been shown the door?

Of course, right now he simply doesn't have the money to do much of anything. A purchase the size of, say, a TV network is unaffordable; even something smaller would be unpalatable. Instead, Roberts will keep launching lower-profile cable channels, which he can count on breaking even almost immediately, given his 21 million subscribers. And he'll use his new influence to

secure more favorable deals for the content he has to buy. Roberts expects to cut \$500 million from programming costs. "No doubt there'll be new tensions in the relationships between distribution and programming companies," says AT&T Comcast board member Decker Anstrom, president of Landmark Communications Inc., which owns the Weather Channel.

These days, it's hard to say who has the toughest job in the business. But heading the country's largest cable company puts Roberts in the running, especially since he has placed the family business in a tough financial position at a time of skepticism about his industry. When Roberts said he doesn't have time to savor the AT&T deal, he wasn't just being modest. It's a good thing he didn't get into this for the glamour.

By Tom Lowry in Philadelphia, with Amy Barrett in Philadelphia and Ronald Grover in Los Angeles

BRIAN ROBERTS

BORN June 28, 1959, Philadelphia.

EDUCATION B.S., finance, University of Pennsylvania's Wharton School, 1981.

JOB CEO, AT&T Comcast.

HEROES His 82-year-old father, Ralph, who founded Comcast in 1963. O.K., who else? "No, seriously, it's only Ralph."

WHAT HE DREAMS

ABOUT Persuading Warren Buffett to buy his company's stock.

AFTER HOURS Plays squash and golf.

LAST BOOK READ *Founding Brothers* by Joseph Ellis.

LAST CD PURCHASED Bought Bruce Springsteen's *The Rising* for his wife.

FAMILY Married to Aileen for 16 years; two daughters and a son.



1977
yearbook
shot: Portrait of a
young investor



WE'VE ALWAYS KEPT OUR PROMISES. WE'VE ALWAYS BEEN A
MUTUAL COMPANY. COINCIDENCE? WE DON'T THINK SO.

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EMBRACING BARBARIANS AT THE GATE

Beaten-up companies looking to go private are seeking buyout firms

Henry R. Kravis is like a kid in a candy store. Three years into the worst bear market since 1929, the legendary dealmaker is buying companies left and right. Since June, his firm, Kohlberg Kravis Roberts & Co., has announced plans to acquire businesses worth about \$7.5 billion. They include a Canadian phone directory publisher and a French electrical equipment maker. Besides, KKR is eyeing hundreds of American companies. "We're busy again. I love it," Kravis says.

The buyout kings are back. Not since the 1980s have the pickings been so rich for leveraged buyout firms like KKR in the high-profit, high-risk business of buying, fixing, and reselling companies. Sidelined throughout much of the late 1990s, when merger mania pushed asset prices out of sight, they are now picking up businesses at bargain prices as companies shed what they couldn't digest. Flush with more than \$100 billion raised from the likes of pension funds, they're emerging as a powerful force in a new wave of restructuring.

This year, LBO deals have soared. Between January and Nov. 6, they were up 50% vs. the same period a year ago to \$20 billion—three-fourths of that rise was in the third quarter when they accounted for almost 10% of all mergers and acquisitions announced. That's their largest share since 1989. By contrast, overall M&A activity shrank 57% to \$379 billion.

Given their vastly in-

creased financial clout, the LBO firms will be key players in refocusing companies on making better use of their capital instead of chasing growth at all costs. "LBO firms will play a substantially more important role in the current corporate transformation than they did in the 1980s," predicts Alan K. Jones, a managing director and co-head of the group that advises buyout funds at Morgan Stanley. "This is their renaissance."

It's not just low prices that are bringing buyout kings out of the woodwork. It's their conviction that they're in the sweet spot. They believe prices are not going to fall much further. At the same time, there's little risk that chastened companies will bid up prices.

"With so many strategic buyers on the sidelines, the environment strongly favors financial buyers," says Sean O. Mahoney, a managing director at Goldman, Sachs & Co. who specializes in LBO financing.

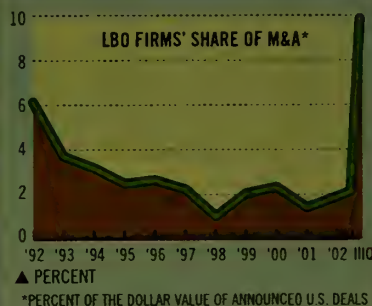
Buyout firms are snapping up hot properties in industries with stable cash flow. Initially, they have focused on yellow-pages publishers, fast-food chains, and book publishers such as Boston's Houghton Mifflin Co. But they're expected to branch out across the economy, as distressed companies like Qwest Communications International, WorldCom, Vivendi Universal International, and Nortel Networks shed more assets.

In many respects what's happening is an about-face from the 1980s, when some buyout funds were the pariahs of the financial world—*Barbarians at the Gate*, as one book dubbed them. Back then, a handful of firms used mountains of debt to buy public companies in hotly contested deals, took them private, then ruthlessly cut costs to make them profitable.

This time around, LBO shops are invited guests. Sellers are thrilled to do deals with them. Managers consider the stock market more punishing than going private under a new owner. Many also see LBOs as their best chance to motivate managers whose options are under water. Once a company is taken private, buyout firms can shower managers with fresh options at dirt-cheap prices that they can cash in when the company is sold. "Our buyouts are management-

LBOs: THEY'RE BACK...

LBO firms are a bigger force in M&A than they've been in more than a decade



...BECAUSE THE PRICE IS FINALLY RIGHT

With companies cheap again, LBO firms have launched some big deals in recent months:

BUYER / COMPANY*	PRICE BILLIONS
CARLYLE GROUP, WELSH CARSON ANDERSON & STOWE	
QwestDex (yellow pages)	\$7.1
KOHLBERG KRAVIS ROBERTS, WENDEL INVESTISSEMENT	
Legrand (electrical equip.)	3.6
TEXAS PACIFIC GROUP, GOLDMAN SACHS CAPITAL PARTNERS, BAIN CAPITAL	
Burger King (fast food)	2.2
THOMAS H. LEE, BLACKSTONE GROUP, APAX PARTNERS, BAIN CAPITAL	
Houghton Mifflin (publishing)	1.7
BAIN CAPITAL	
Unisource Worldwide (paper)	1.4

*ALL DEALS ARE PENDING

Data: Thomson Financial, Capital IQ Inc



With more than \$100 billion in cash, LBO firms are emerging as a powerful force in restructurings

nies are better run," says Perry Golkin, a member of KKR. Adds Harold W. Bogle, a managing director at Credit Suisse First Boston: "You have to look to grow in more strategic ways."

That's why many buyout firms are rolling up their sleeves and getting involved in running the companies they buy. For example, Texas Pacific Group partners made sales calls on the top 15 customers of silicon wafer maker MEMC Electronic Materials Inc. to convince them the company was financially sound. "Firms will be substantially more hands-on than they historically have been," says James G. Coulter, a founding partner at Texas Pacific.

The pressure on firms to deliver returns may even spark another flurry of mergers—this time between the companies in buyout firms' portfolios. "You may see more financial buyers selling to financial buyers," says Carlyle's Conway. They may drive a hard bargain, though. In the mid-1990s, says Mark L. Sirower, head of the M&A practice of The Boston Consulting Group, corporate buyers on average lost 5% of what they paid for businesses, while LBO firms made

roughly 25%. The superior returns show how closely major buyout funds scrutinize their deals. On average, they pick only one out of 100 they consider. "The difference is that corporations often acquire to be bigger. LBO firms acquire companies to make money," Sirower says.

Not that the LBO firms always get it right. Many are still nursing their wounds after straying from cheap, un-

derstandable businesses at the peak of the market. In 2000, LBO firms did \$40 billion of deals after many lost patience waiting for the stock market to decline and took ill-fated gambles. Big firms—including Forstmann Little & Co. and Hicks, Muse, Tate & Furst Inc.—together lost billions of dollars on telecom investments made around that time. "I guess we could have all taken a year off and played golf, which would have been a great idea in hindsight," says Thomas O. Hicks, co-founder of Hicks Muse.

This bitter experience is making buyout firms a lot more cautious. Many are forming consortia to share the pain if deals go sour. On Oct. 31, four buyout shops—Thomas H. Lee Partners, the Blackstone Group, Bain Capital, and Apax Partners—said they teamed up to buy Houghton Mifflin from Vivendi.

This newfound caution sits well with today's LBO investors. More public pension funds are backing buyout firms than in the 1980s, and they face heightened scrutiny of their own investments. For example, the University of Texas Investment Management Co. (UTIMCO) recently decided to release its LBO returns on request—breaking a taboo for the secretive firms. "The board felt with the changes that had taken place in the overall environment, we would have to move to a higher level of disclosure," explains Bob Boldt, president of UTIMCO.

The less forgiving business climate presents other obstacles. For starters, bond investors to whom the LBO firms turn for debt financing are getting wary of big deals. And, because many of the companies for sale face shareholder lawsuits and investigations, it's becoming more complicated to close deals on schedule. For instance, the news on Nov. 4 that Vivendi's financial disclosures are under investigation by U.S. and French authorities could thwart the Houghton Mifflin deal. "I'm sure that is complicating the effort to close a sale," says Jonathan Newcomb, former CEO of Simon & Schuster Inc. and now a principal at private-equity firm Leeds Weld & Co.

For now, the buyout kings aren't too worried. They're giddy over the great American fire sale. Plenty more cheap merchandise will hit the racks. "We always thrive when there is turmoil in the markets, and God knows we have turmoil," says Kravis. When the going gets tough, the tough go shopping.

By Emily Thornton in New York, with Stephanie Anderson Forest in Dallas

ed," says William E. Conway Jr., a co-founder of the 15-year-old Carlyle Group. "Hostile takeovers are a thing of the past."

But it's not going to be as easy for LBO firms to extract profits from their prizes. Their slash-and-burn methods are now standard management procedure, so there's less fat to cut. "Our job is a lot harder today because compa-

PEOPLE

IDENTICAL? DON'T YOU BELIEVE IT

Rob Gensler is the star fund manager, Gary the industry critic

The Gensler twins are like the proverbial peas in a pod, only more so. They are a 99.99% molecular match. Their slight builds and receding hairlines are carbon copies. But as mirror-image siblings—who occur in only one of every 1,000 twin births—they also have distinct differences. The phenomenon produces such traits as hair whorls, or fingerprints that twist in opposite directions. In the Genslers, one is left-handed and parts his hair on the right (Robert). The other is right-handed and parts his hair on the left (Gary).

But there's more here than meets the eye. The 45-year-olds' views on politics and business couldn't be further apart. Democrat Gary, the elder by three minutes, is co-author of *The Great Mutual Fund Trap: An Investment Recovery Plan*, which lambastes the \$6 trillion industry for perpetuating the myth of the Star Manager. Its main premise: The notion that actively managed funds can beat the market through deft stock selection is a hoax. And fees are too high. He says that investors are better off buying funds that track an index, such as the Wilshire 5000. The "trap" is believing that

anyone can deliver above-average returns.

Turns out that identical twin Robert, a Libertarian, is an odds-defying star money manager at Baltimore's T. Rowe Price Group Inc. His \$430 million Media & Telecommunications Fund was ranked No. 1 in its category last year, losing 7% vs. an average 36% loss by peers. He beat the overall stock market, which lost 14%, by a mile. And he did that by buying stocks in the second-worst-performing sector—no small feat. He's still ahead of his telecom fund peers this year, though the fund has lost 27%. Analysts say he buys companies with strong free cash flow and sound balance sheets. And he has avoided the blowups like Xo Communications Inc. "It's not about picking winners, it's about not

making as many mistakes," says William Harding, senior analyst with Morningstar Inc. "It speaks to Gensler's ability to pick stocks."

The philosophical differences don't end with mutual funds. Gary, who served in the Clinton Administration, helped Senator Paul S. Sarbanes (D-Md.) write one of the pieces of legislation that financial services firms hate most: the Sarbanes-Oxley Act, which calls for an industry overhaul. He is outgoing, with the ingratiating manner of one destined for politics. By contrast, Robert leans decidedly to the right. He is more abrasive, recalls Julian C. Stanley, founder of the Study for Mathematically Precocious Youth at Johns Hopkins University, where the brothers studied as teenagers. Both have had Wall Street careers, but on different tracks: Gary joined the 133-year-old Goldman Sachs Group Inc., making partner before he was 30. Robert earned his stripes from the scrappy Salomon Brothers, now part of Citigroup.

Gary's criticisms have turned heads at T. Rowe. "Advocates of indexation are not new," says Chairman George A. Roche. "But highly skilled managers help people achieve their financial goals." Robert's co-workers have taped notes to his office door, and asked, "Was your brother dropped on his head at birth?" While Gary acknowledges his brother's accomplishments in the book, he says: "It's too hard to find the Rob Genslers. I hope that more investors use common sense and go with passive investing."

Robert hasn't read Gary's book and doesn't intend to; he'd rather play with his kids, he says.

Robert has had his pay-

ROBERT N. GENSLER

- Manager of Morningstar's four-star rated T. Rowe Price media/telecom and global tech funds
- Proponent of stock-picking: "To just index your money and forget the rest doesn't work"
- Began at Salomon Brothers in M&A risk arbitrage department, betting on deals of the sort made by his brother
- Spent career in private sector in banking and money management, except for two-year, post-MBA stint in Peace Corps
- Libertarian

GARY GENSLER

- Sharp critic of the mutual fund industry; co-author of *The Great Mutual Fund Trap*
- Strong advocate of indexing: "The trap is believing that the experts can help you beat the market"
- Started career in white-shoe Goldman Sachs as an M&A dealmaker
- Public servant: Former Treasury Under Secretary under Clinton; senior adviser to Senator Paul Sarbanes on financial reform
- Democrat





HOW DOES E*TRADE FINANCIAL PLAY TO WIN?



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Winning with Linux® and Intel® Online diversified financial services company E*TRADE Group, Inc., has just installed 90 IBM @server xSeries™ servers running Linux to support their E*TRADE Financial Web site. Why? Ease of use and Linux driven affordability and scalability. Select xSeries models feature the Intel Xeon™ processor to give you superior performance and cost-effectiveness. To receive a complimentary IDC white paper on how to reduce TCO with Linux, head over to **ibm.com/eserver/etrade**

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back. Because of his stellar performance, he's in hot demand by the media for rating stocks and making market calls. That riled Gary's co-workers in the Clinton Administration. Treasury officials, especially, are forbidden from making public comments on the market. So whenever Robert appeared on TV, the switchboard automatically lit up at then-Treasury Secretary Robert E. Rubin's office with complaints about Gary.

Given their high profiles, incidents of mistaken identity dog the Genslers. When Gary was sworn into office at Treasury, Rubin, now a senior executive with Citigroup, heartily congratulated brother Robert by mistake. "I think we have a security problem," quipped Gary. Later, Robert compounded the confusion by receiving guests at his brother's congratulatory party. "Rob's no longer allowed near the front door at my parties," says Gary.

The days of deliberately swapping identities for kicks have been behind them, mostly, since college. At 18, the two young math prodigies shared not only looks and last names, but identical intellects. Both wound up as classmates in a freshman, honors-level economics class at the University of Pennsylvania's Wharton School. The semester's first test set the tone: When it was announced that only two students scored higher than 50 points, Robert shot off a hurried note to his brother. His score was 51. Gary wrote back: "We must be twins; 51." Says Robert, reflecting on both the past and present: "There's no one I'd rather lose to, but I'd rather win."

That piece of paper, crinkled with age and a permanent fixture in Robert's wallet for the better part of 27 years, is a symbol of respect—and fiery competition between brothers. Repeat marathoners both, they have pushed each other to excel. Born the youngest two in a modest, middle-income family of five—of parents who never went to college—the Gensler boys are each other's muse. "It's not that they try to outdo each other," says mother, Jane, "they just try to keep up with each other."

Mother knows best, and so, apparently, do older brothers. When asked about the Wharton test scores, Robert mistakenly recalled he had lost by one point. Gary—who completed both undergraduate and graduate work there in four years, graduating summa cum laude—replied: "Did I beat him? I thought we had tied." His book may not turn into a best-seller, but with such tact, a political career could be in the cards.

By Mara Der Hovanesian
in New York

COMMENTARY

By Heather Timmons

J.P. MORGAN: PIERPONT WOULD NOT APPROVE

What would J. Pierpont Morgan do? J.P. Morgan Chase & Co., the behemoth that now bears the legendary financier's name, is a mess. After Morgan shocked Wall Street on Sept. 17 by announcing a \$1 billion increase in bad loans and a \$1 billion decline in trading revenues, its stock hit decade lows. It was so cheap Street tattle had it that British-based global bank HSBC Holdings PLC and Chicago's Bank One Corp. might be interested in buying it. Neither bank, nor Morgan, would comment.

Pierpont the iron-willed capitalist often found himself in such tight corners. "It was a wildly speculative marketplace in those days," says biographer Jean Strouse, author of *Morgan: American Financier*.

"Railroads weren't a sure thing. Some turned out to be Microsoft and some turned out to be Enron." But, good or bad, Pierpont took what Strouse calls "moral responsibility" for the deals.

He certainly wouldn't have played for sympathy over the tidal wave of bad corporate debt and defaults that has washed over Morgan and other banks. The present head of the House of Morgan, CEO William Harrison, wrote in *The Wall Street Journal* on Sept. 18 that banks "have been among the parties most damaged" by fraudulent accounting, and shouldn't be made scapegoats. Investors in \$11 billion of WorldCom Inc. bonds issued by Morgan and Citigroup, now worth cents on the dollar, don't agree: They're suing the banks for allegedly failing to do proper due diligence before underwriting the bonds. Morgan and Citi contend they've done nothing wrong.

Although Pierpont was prone to

debilitating fits of depression when his business wasn't going well, he was steadfast in his determination to fix his own problems. He often applied a process that was called Morganization. He would take over problem companies, flush out incompetent managers, and appoint people he trusted. Over time, many of the companies would recover and become profitable, keeping capital flowing into other Morgan deals.

A touch of that is needed now. The bank's current problems stem from an ill-timed merger. Chase Bank bought J.P.

FOOTSTEPS

Management needs to make some bold moves. Otherwise, J.P. Morgan Chase is a target

Morgan in 2000, just before the stock markets tanked and investment banking deals dried up. Today, its \$22.50 stock price is a steal compared with

a conservative \$30 sum-of-the-parts valuation of its main businesses, according to E. Reilly Tierney, banking analyst at boutique investment bank Fox-Pitt, Kelton. The asset management group alone has \$492 billion in assets under management and could fetch at least \$1.5 billion.

To avoid being bought and forcibly broken up, Pierpont's successors need to face up to their problems and knock the bank into shape. That may mean hiving off less profitable units, streamlining their operations to cut costs, and focusing their business model. A cut of over 2,000 investment banking jobs in October was a start. But as Pierpont said, "You cannot pick cherries with your back to the tree."

Timmons covers banking.



ACTIVISTS

REVENGE OF THE RETIREEES

Ex-execs are battling their old bosses over benefits

When C. William Jones retired from Nynex in 1990, the company feted the debonair managing director with a toast-filled bash at "1095," a tony midtown Manhattan headquarters. The VIPs gave Jones a plaque commemorating his 30 years of service, a Linolta camera, and a flurry of old-boy handshakes. Like hundreds of others before him, they then sent Jones on his way, expecting him to do as any company lifer does: go quietly into the good life, whittling away his handicap at the club and logging some luxury travel with the wife.

Little did they know that Jones, 64, would be back—not as an executive as-been but as a leader in a rapidly growing movement: the revenge of the company man. Jones now heads the 90,000-member Association of BellTel retirees. The group is one of many in a new, nationwide organizing effort made up of former white-collar managers and execs who are disgusted by corporate greed and outraged by pension and health-coverage takebacks. It could be one thing, they say, if the

promised benefits were being slashed for the good of the company. Instead, they're watching CEOs bank hundred-million-dollar fortunes. "It's not unions out there saying this to executives," says Karen Friedman, director of policy strategies for the Pension Rights Center. "These are people who used to be them."

These revolutionaries in Izods are fast becoming a formidable force. Whereas a few years ago just a handful of agitators were on the scene, hogging the mike at annual meetings and firing off largely ignored letters to CEOs, today there are more than 2.5 million. They are flocking to retiree groups fighting IBM, General Motors, Boeing, Western Union, U.S. West, Qwest, and Verizon, among others. Armed with their well-honed managerial skills, they use flashy Web sites, lawsuits, proxy proposals, and political pressure to further their cause. So far they've been successful in backing a new bill before the Senate and House that would protect retiree medical coverage, the latest benefit that has fallen under the corporate scalpel.

Their chief target: the legions of large companies that stopped giving retirees their cost-of-living increases in the early 1990s—even as they used the bal-

looning pension surpluses to pump up profits. Jones points out that Nynex retirees haven't gotten a pension hike since 1991—even though the new parent company, Verizon, had \$12 billion in excess pension funds in 2001 and pays \$3 million a year in consulting fees to retired Co-CEO Charles R. Lee. "They are now starting to view retirees as a cost center," says Jones. "And they're cutting their losses." Verizon counters that its benefits stack up well against those of other companies.

In April, Jones's BellTel retirees came close to their biggest victory by winning 42.8% of the vote on their

ORGANIZATION
MAN: Jones leads the 90,000-strong BellTel group

proxy proposal to bar Verizon from including pension earnings in its calculations for executive

compensation. Verizon says the issue will likely be resolved through new accounting rules. Jones vows to be back on the ballot in 2003.

Plenty of other groups have also notched gains. This year, a retiree class action brought against Sears, Roebuck & Co. pressured the company into offering partial relief after it cut life-insurance benefits. And IBM workers continue to fight Big Blue over its new cash-balance pension plan, which offers many workers a substantially smaller payout than what they would have gotten under the old system. So far, the group, made up of current and former employees, says its efforts helped persuade IBM to exempt employees age 40 and above from being forced into the new plan. But they are still fighting for younger workers. "These people were promised a secure retirement," says former IBM engineer James Leas, a retiree organizer, "and now they're not getting it." IBM declined to comment.

Lately, the groups have been drawing blue-collar colleagues. Disgruntled Gen Xers—as well as boomer managers unable to retire—are also secretly joining, offering up valuable inside information about new cost-cutting schemes in the works. In this downturn, some of Corporate America's toughest critics are coming from within.

By Michelle Conlin in New York

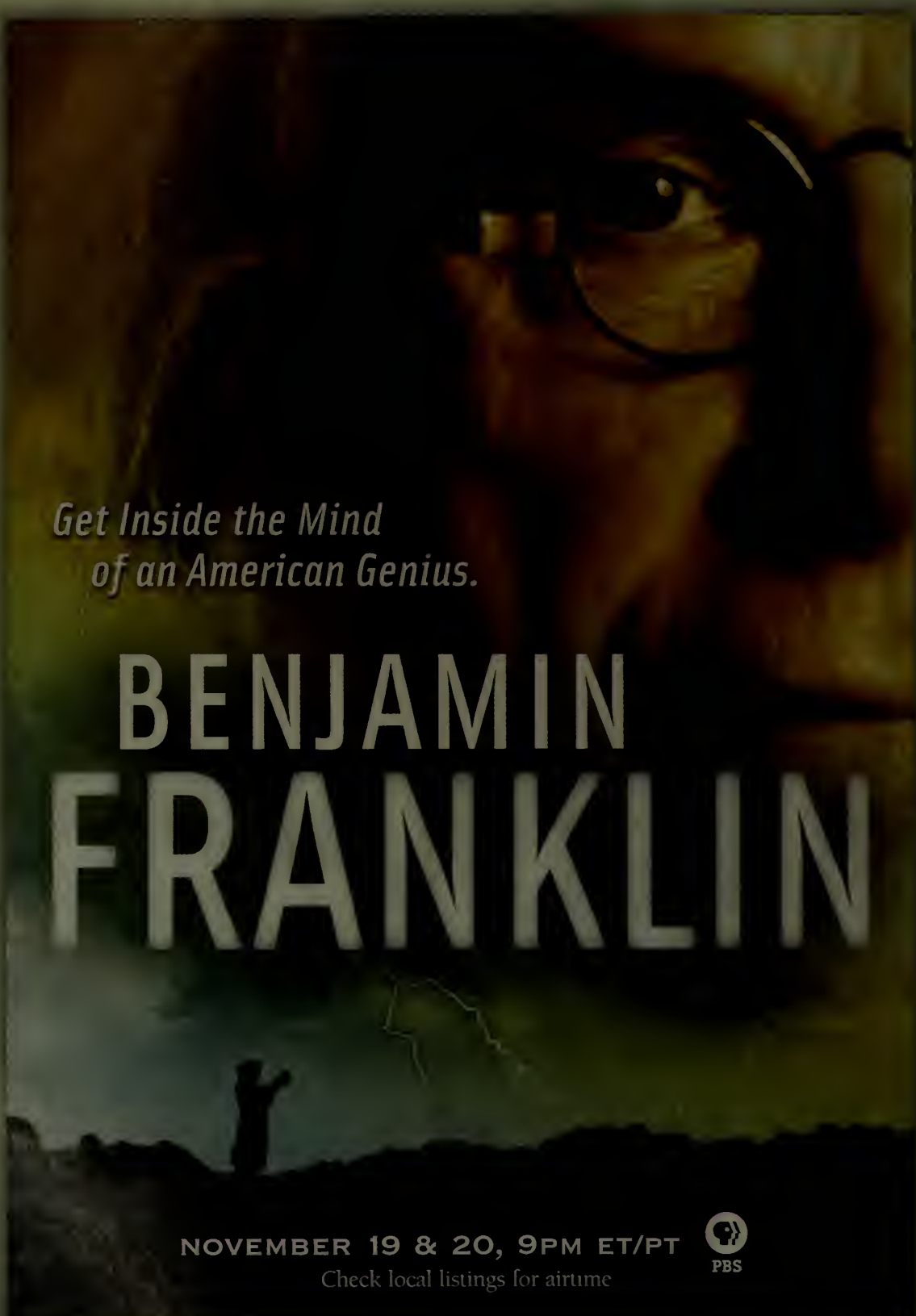
IZOD AGITATORS

Retirees are revolting against cutbacks in pension and health benefits. Some recent gains:

- ▶ BellTel retirees nearly won a proxy vote in April that would bar now-Verizon from using pension earnings to pump up exec pay
- ▶ Boeing, US West, and Western Union retirees, among others, are backing proposed legislation that would protect medical coverage

- ▶ Sears retirees won partial relief from company moves to cut their life insurance
- ▶ IBM employees pressured the company into exempting older workers from less generous "cash balance" plans

Data: Pension Rights Center, *BusinessWeek*



*Get Inside the Mind
of an American Genius.*

BENJAMIN FRANKLIN

NOVEMBER 19 & 20, 9PM ET/PT
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BusinessWeek

Investor

MAKING LIFE RICHER

Beneath the Surface

How to decipher analyst reports **Page 136**



FASHION 130 Suiting Up, Again
REAL ESTATE 134 Put It in Your IRA
BARKER 144 A Different Way to Index



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TODDI GUTNER

THE STAT

\$16.1

ILLION. What investors pulled out of equity mutual funds in September—the largest monthly outflow since September, 2001, and the second largest ever.

Source: Investment Company Institute

IDENTITY THEFT

THAT WASN'T ME!

How to protect your social security number

Noticed some strange charges on your credit-card bills? Someone may have gotten your Social Security number. Here's how to counteract the growing crime of identity theft:

DON'T carry your Social Security card with you.

REQUIRE credit-card companies to contact you before approving additional credit.

REPORT misuse of your SSN to Social Security Fraud Hotline at 800 269-0271.

Ellen Hoffman

NUMBER NABBINGS

Reported incidents of Social Security number misuse.

9 29,000

0 46,795

1 65,220

2* 72,605

*estimated

Source: Social Security Administration



INVESTING

Hedge Heaven

HEDGE FUNDS HAVE historically been about as secretive and exclusive as Freemasons. But they're raising their profile, if just a bit, by offering their funds in a new financial supermarket at **HedgeWorld.com**. It's an important step toward making the industry more investor-friendly.

HedgeWorld hopes to do for hedge funds what Charles Schwab did for mutual funds. The supermarket now carries only 100 hedge funds, but 3,000 others have inquired about shelf space. You still must have at least \$1 million in assets to invest. But now you can research, track, and trade them in one place. Traditionally, this business "required investors to make many phone calls and analyze the hedge fund themselves before buying it," says **Johann Wong**, CEO of HedgeWorld in White Plains, N.Y. "This simplifies the whole process."

That said, trading at the site is not as simple as making mutual fund transactions. You also have to wait to get in and out of a fund. Still, it beats begging your buddies for help into an oh-so-exclusive hedge fund. *Lewis Braham*



GADGETS

CLEVER CAMERA

With two new **Casio digital cameras**, you'll never have to ask a stranger to take a picture of you and a friend. The **\$400** 3-megapixel **QV-R3** and the **\$500**, 4-megapixel **QV-R4** lets two people snap each other separately against the same background. The cameras then line up the images so it looks like one photo. *Larry Armstrong*

TIME OFF

TRAINS GET THEIR DAY

Admit it. Many of you haven't outgrown your fascination with **trains, trucks, and things that go**. To stir up those old feelings, hobby-magazine producer Kalmbach Publishing declared **Nov. 15 Take a Model Train to Work Day**. The idea is

that show-and-tell by many of the **500,000 model railroaders** will spark interest in the pastime. Tom Peters sees in trains the same things he appreciates about the cars he designs for General Motors: "the functionality, variety, and technology." That's called mixing work with pleasure.



The Suit Is Back In Business

And now, it's sporting more colors and patterns. **BY CHRISTINE SUMMERSON**



BUSINESS CASUAL had its day, and sure, it was fun. But now, the suit is not only starting

to feel right again, it has returned in full force at companies that have reinstituted formal dress codes, among them investment banks Lehman Brothers and Bear Stearns.

If you're venturing into the suit department for the first time in years, you'll find some changes. In a market long dominated by black and gray, new colors are coming into vogue, particularly seasonal tones. Plaids and stripes appear with greater frequency. Fabrics often have texture woven in. More choices? Sure. But there is a return to a classic look that is easy to update.

UPDATING A CLASSIC

Wool-and-cashmere suit in glen plaid (\$1,564), with burgundy striped French-cuffed shirt and plum print tie, by Paul Stuart

How to know when a suit's gotta go

1 Poor Fit If you haven't worn it in three or four years, you've probably outgrown it

The Suit

Both two- and three-button **jackets** are appropriate; what you select should be more a matter of which looks better on you. They're also somewhat fitted, not boxy. Both single- and double-vented jackets are popular, with perhaps an edge going to double-vented. Lapels remain relatively narrow at 3½ to 4 inches, and in the classic style, the notch will tend to be higher, rather than lower.

The most popular **shoulder** treatments are "soft" and "semi-rope."

On a larger man, a **soft** shoulder is

better, says Fred Derring, CEO of New York-based DLS Outfitters, who consults with independent men's specialty stores. "A thinner guy would look better in **semi-rope** because it gives him more shoulder," thanks to a little padding in the cap of the sleeve.

Double-breasted may still be the ultimate **power suit**, and several designers are bringing it back. It has "a dignity, a certain 'I've arrived' look," says Clifford Grodd, president and CEO of Paul Stuart in New York. But it loses points on comfort. The jacket must be worn buttoned, he says, or it will look sloppy.

Suit **fabrics** are the big story. The new ones bow to tradition and then go a step further. A pinstripe will have two colors, not one. Accents of blue are showing up, Derring says. A **chalk** stripe may have the faintest hint of color, such as pink. Flannels have sophisticated, subtle patterns. **Glen plaids**, which started showing up for fall, will be a bigger option for spring. **Windowpanes**—a chalk or pinstripe woven in a 2-inch grid pattern—look classic and new at the same time. Nails-head fabrics are bi-color; the lighter color shows up as a tiny dot. For a basic look, Brooks Brothers uses a 100% wool stretch fabric, made without spandex, in a line of suits in the \$600 price range. You shouldn't buy any suit jacket that doesn't fit you perfectly around the neck, without gaps, and in the shoulders. Otherwise, the suit will require a substantial amount of tailoring and quite likely will still not fit you properly. Problems below the shoulder

are easier to correct. Most men wear pleated trousers, which as a rule, should always have cuffs. If you favor flat-front slacks, remember: No pleats means no cuffs, either.

The Shirt

You may have the most fun in the shirt department. People will look at your shirt and tie even before they look at your suit. "One of the biggest mistakes is buying cheap shirts to go with an expensive suit," says Andrew Kozinn, president of Saint Laurie Merchant Tailors in New York. You're better off if you focus on great-looking shirts.

Dark colors aren't as popular in shirts as they were several years ago, says Colby McWilliams, vice-president and men's fashion director at Dallas-based Neiman Marcus. And lots of men are buying more **white** shirts this season.

Blue is still the No. 1 color in solids, Derring says, including the deeper French blue. "We think that will continue, but the new additions will be **stripes** and **tattersalls**." To see stripes and checks in their most creative

HINT OF COLOR WITH GRAY AND NAVY

From top: Charcoal with pale pink bead stripe; charcoal with lavender windowpane; navy multi-stripe with purple



SHADES OF BLUE

Sophisticated patterns include, from the outside, a tiny houndstooth, a check with lavender, thin stripes alternating with black, and a basic stripe, at Bergdorf Goodman

Broad Shoulders

They look dated, unless you're in the NFL

3 Slouchy Style

Designers aren't slouching much anymore

4 Low Button

Stance You don't want those jacket buttons below the waist

5 Permanent

Rumples Along with shiny fabric, these are obvious signs of distress



iterations, take a look at shirts by Thomas Pink, Turnbull & Asser, Charvet, and Borrelli—but brace yourself for price tags from \$125 to \$325. Button-down and English spread collars are still the most popular. French cuffs are great for a dressier look, but button cuffs are fine if you don't like cuff-links. The fabric: 100% cotton, of course.

The Tie

The lavish \$100-plus silk **print** ties such as those by Hermès and Ferragamo are still hot. But some of the freshest looks are **textured** fabrics with stripes, woven patterns, and dots. Conservative suits look great with bright ties. For bolder suits, ties in subtle colors with woven patterns can play off the jacket nicely.

In the end, details make the difference between the suit-as-uniform and the suit that shows off your **personal style**. If you're replenishing your wardrobe, "look at interesting ties and shirts with patterns to set you apart and give you a more updated look," says Robert Burke, vice-president and

senior fashion director at Bergdorf Goodman.

You can match checked shirts with plaid or striped suits, for instance, or checked shirts with patterned ties. And brown shoes do make it with gray and navy suits. How do you develop an eye for this? Mainly, it just takes **practice**. To start, pick combinations that appeal to you and don't hesitate to ask a salesperson for help.

Buying a good suit is an **investment**, says Paul Stuart's Grodd. "Look at people in your industry, and if you see something you like, ask where they get their stuff," he advises. "Walk around. Shop. Look at other customers. Buying clothing should be unique, exciting, fun."

Clothiers are unanimous on one point: Don't dry clean your suits often. Use a clothes brush instead. The payoff: "There's nothing more **dashing** than an elegant, sophisticated suit," Grodd says. Can't argue with that. ■

Looking slimmer:

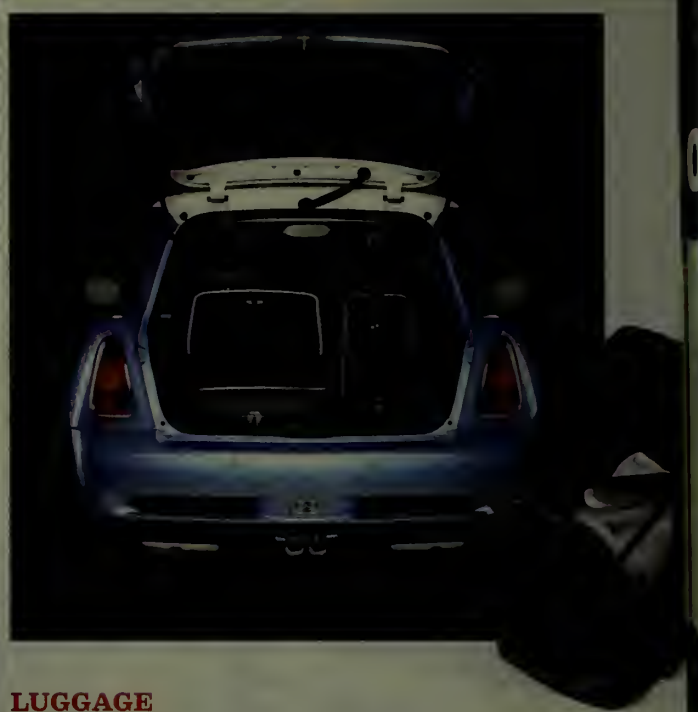
Clothiers have many tricks for making a man look thinner in a suit, says Clifford Grodd of Paul Stuart:

■ A two-button jacket emphasizes the vertical, while a three-button suit creates bulk because of the extra fabric across the chest.

■ A double vent gives a more natural drape to the fabric in an area where you don't want it to cling. Having no vent "accents the butt," Grodd says.

■ Trousers with a thin pleat are cut with a straight leg and are narrower in the thigh.

■ Suspenders look snappy and elongate the torso. "A belt," Grodd adds, "brings the eye down."



LUGGAGE

Maxing Out for Mini Efficiency

The diminutive Mini Cooper is surprisingly spacious and comfortable, even for long road trips. Pity there's not much room for luggage.

BMW, Mini's maker, knows that cargo space is a problem and asked Samsonite to come up with the solution. This fall, Samsonite unveiled its answer: **a three-piece set of luggage custom-designed to fit the space in the boot perfectly**. There's a tote that converts to a backpack, a larger duffel, and an upright carry-on with chrome-hubbed wheels that reflect the Mini's own. Fabrics, hardware, and details match the Mini's interior, including reflective piping that's also found on the floor mats and orange push-button locks modeled after the turn signal indicator light. The set, available online (miniusa.com) and at Mini dealerships since September, sells for \$467. Now that's traveling in style.

Larry Armstrong

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Add a House To Your IRA

But this real estate play can be complex—and costly.

BY ELLEN HOFFMAN

IF YOU'VE BEEN ITCHING to invest in property but have held back because you're short of cash, you might be overlooking a bundle right under your nose: your individual retirement account. Many don't realize they can use money in an IRA to buy real estate instead of mutual funds, stocks, or bonds. "You can't put anything but cash [directly] into an IRA," says Internal Revenue Service spokesman Don Roberts, "but once you have the cash in... there is no prohibition on purchasing investment property with it."

This strategy isn't for everyone: It can be complex, costly, and require the help of a tax adviser. But if done right, it can be a smart investment. Jim Maxwell, owner of a Ridgefield (Wash.) business that arranges tax-favored real estate deals, has gone this route himself, using \$70,000 of his IRA assets in 1999 to buy five acres of prime development land he says is now worth \$125,000.

One benefit to acquiring real estate through an IRA is that if you sell at a profit, you can postpone or totally avoid paying taxes on the gains. If you make the transactions through a tax-deductible IRA, you'll pay ordinary income tax when you start taking money out after age 59½. Chances are you'll be re-



tired and your tax bracket will be lower at that point than it was at the peak of your career. Even better, you'll escape tax altogether if you buy the property in a Roth IRA and hold it for at least five years before selling.

Don't rush out to buy that two-family house. The IRS doesn't let you hold your own residence in your IRA, nor can any-

one in your immediate family live on the property. But you could buy a home with the intention of moving into it in the future, says Debra Greenstein, president, Entrust Administration, an IRA custodial company in Oakland, Calif. The transaction would need Labor Dept. approval and rack up some \$3,500 in fees.

HIRED HELP

Costs can add up, because you'll need to pay for help to make the purchase, oversee the account, and—if you want to acquire a building with tenants—handle the management. The IRA should also have enough cash to pay for mortgage, taxes, and other related expenses. Yet if you put in more than the annual limit—\$3,000 in 2002 (\$3,500 for those 50 and older) to pay the bills, the IRS will impose a 6% penalty on your excess contribution. Keeping six months of mortgage payments in the IRA provides a comfortable cushion.

Another wrinkle can occur when you turn 70½, when you're required to start withdrawals. The distribution amount depends on your age and the fair market value of your IRA assets. If your account lacks the cash to meet the withdrawal requirement, you'll have to sell the property—even if the market is down. Finally, Hug Bromma, CEO of Entrust, says unless you plan the purchase and sale carefully, you could be hit with the "unrelated business tax" of 39.6%. Consult a tax expert.

The real estate play wouldn't suit those who need to keep an IRA liquid. But if that's not an issue, the strategy gives stock-shy investors a chance to participate in a very desirable market.

SAVINGS

Small Change?

Changing spending habits just three times a month can really add up.

Using only your own bank's ATM

ANNUAL SAVINGS:

\$54

Buying regular coffee instead of lattes/cappuccinos

ANNUAL SAVINGS:

\$63

Preparing lunch at home instead of dining out

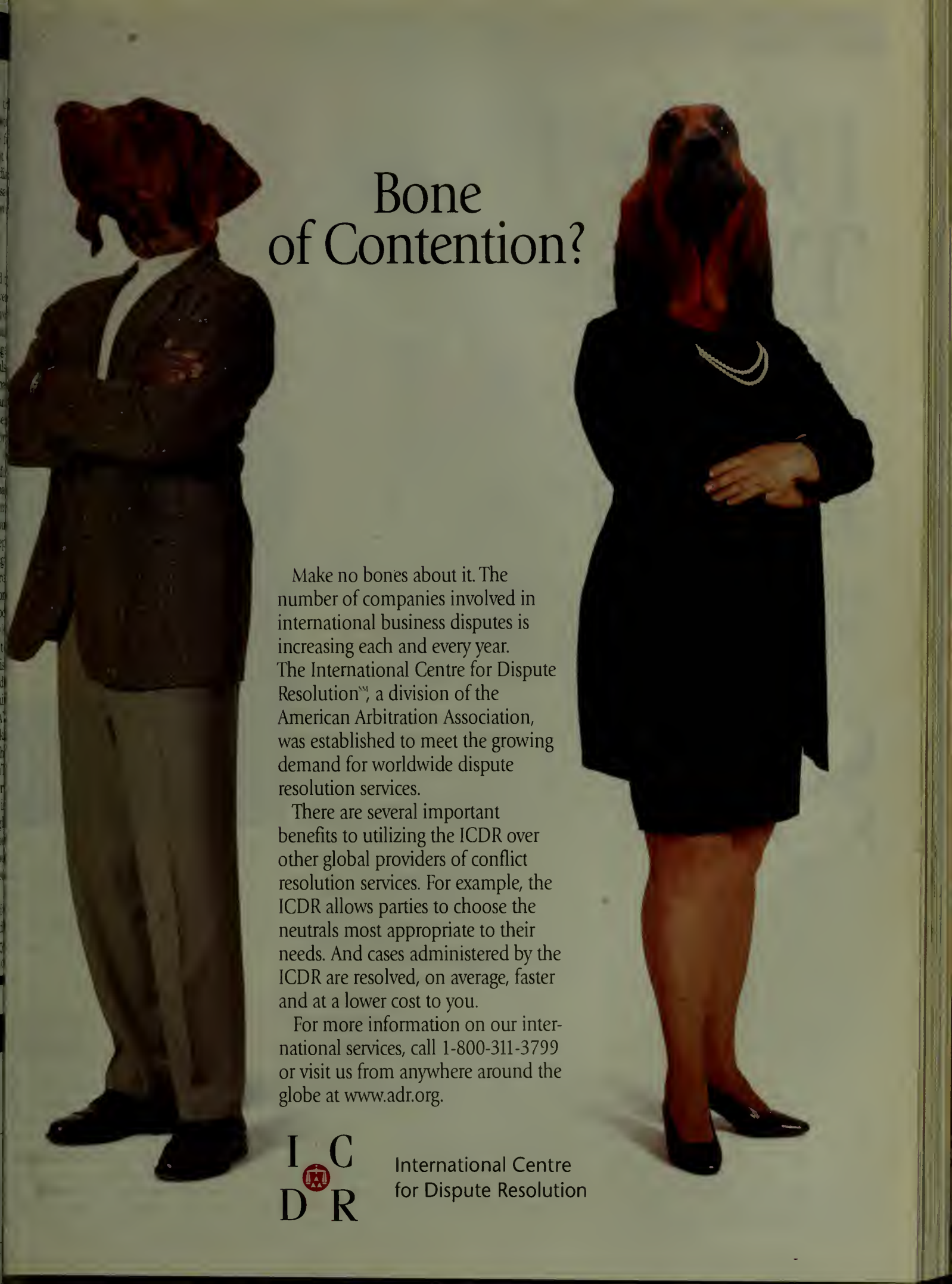
ANNUAL SAVINGS:

\$234

Borrowing books from the library instead of buying

ANNUAL SAVINGS:

\$720

A man and a woman with dog heads, specifically Weimaraners, are standing on either side of the text. The man on the left is wearing a brown suit and tie, with his arms crossed. The woman on the right is wearing a black dress and a pearl necklace, also with her arms crossed. The background is a plain, light color.

Bone of Contention?

Make no bones about it. The number of companies involved in international business disputes is increasing each and every year. The International Centre for Dispute Resolution[™], a division of the American Arbitration Association, was established to meet the growing demand for worldwide dispute resolution services.

There are several important benefits to utilizing the ICDR over other global providers of conflict resolution services. For example, the ICDR allows parties to choose the neutrals most appropriate to their needs. And cases administered by the ICDR are resolved, on average, faster and at a lower cost to you.

For more information on our international services, call 1-800-311-3799 or visit us from anywhere around the globe at www.adr.org.



International Centre
for Dispute Resolution

Don't Toss Those Analyst Reports

They often can yield nuggets of insight
—if you're willing to dig. **BY CAROL MARIE CROPPER**

STOCK ANALYST bashing has become a popular sport—and for good reason. Whether Wall Street firms, the Securities & Exchange Commission, and the New York attorney general will be able to hammer out a deal that produces stock reports truly untainted by investment banking ties remains a big question. But, regardless of the outcome, don't dismiss the reams of research that analysts are churning out now. Some of their misuses contain insights into a particular industry or company that can be incredibly helpful to an investor. You just have to know how to dig beneath the surface—and what to do with the information you find.

Forget those buy, hold, and sell recommendations and analysts' price targets. The recommendations are notoriously upbeat, the price targets unreliable. Instead, use the material in the reports to form your own conclusions. The best reports include industry analysis that's difficult to find elsewhere or proprietary research available only from that ana-

lyst or investment house. The language may be jargony, but the report just might contain tip-offs obscured by a frothy buy recommendation. A recent study by two Boston University School of Management professors found that while analysts can't be relied upon to slap a sell on a company about to go under, they do often raise red flags that would alert an astute investor. In October, 2000, as the Boston U. study points out, Sanford C. Bernstein gave troubled LTV an "Outperform" rating, but warned within the report that "business is lousy, and the company is bleeding badly."

LTV went bankrupt two months later.

So study the reports closely. Just because analysts are prone to hype doesn't mean they can't provide sophisticated information you might otherwise miss. Remember, many analysts are MBAs, CPAs, or CFAs who have spent years following the companies in their industry. Respected ones, such as Credit Suisse First Boston's Lara Warner, who follows the cable industry, provide insights that would be hard to find elsewhere. In a recent report, she warns

that cable companies' bottom lines will be hit as they begin booking the cost of installation as a current expense rather than writing it off over time as a capital expenditure. "The impact of this cost shift dampens cable EBITDA [earnings be-

Forget the buy, hold, and sell recommendations. Instead, use the material to form your own opinions

fore interest, taxes, depreciation, and amortization] by 300 to 500 bps [basis points], limiting long-term margins to 38% to 40%," she warns. Translation: The amount of profit to be made off each cable customer will drop.

Look for the analyst's explanation of any strength or strategy that makes a company unique within its industry or



more likely to succeed than others. Check if it's an industry leader or one of the dogs pulling up the rear. Weigh the analyst's justification for growth predictions for the broad industry it's in.

Some reports have more of these perceptive nuggets than others. But even so-called "maintenance" reports, which come out around quarterly earnings season and explain what has happened lately, can be valuable. They discuss trends in company earnings and give company executives' predictions.

RED FLAGS

These reports can alert you to changes that might cause investors to alter their opinion of a stock—and move its price—such as a new management team or a recent merger that's not working out. If earnings are down, a good analyst should explain whether he or she thinks it's because of the overall economy, a downturn in the industry, or a problem specific to the company. If it's the latter, the analyst should say whether the weakness is temporary or permanent. And if it's because overcapacity is swamping the entire industry, does the analyst believe supply and demand will come into balance soon, or take months?

A few analysts still do proprietary research, gathering information you won't find elsewhere. Morgan Stanley's Bill Pecoriello may be a perpetual bull on PepsiCo. But even if you don't buy his bubbly outlook, studies such as the one in his Oct. 9 report can help

you make a more informed decision. The Morgan Stanley poll of 1,000

As we highlighted a few weeks ago, the cost of churn for the cable industry is poised to double over the next 4 years from \$2.2B to \$4.4B in 2006 driven by high churn rates and acquisition costs.

We believe these costs are also currently being capitalized in the form of installation labor. We estimate install labor will grow from \$15-\$30 per subscriber in 2001 to \$50-\$90 by 2010.

While this treatment comp...

50% of all consumers and, increasingly, calorie content

(55%).

INDUSTRY DOPE

Analysts who have spent years following an industry can provide valuable perspective. The excerpt above, in a Credit Suisse First Boston report on the cable-TV industry, looks at accounting issues that could affect earnings. The table at right is from a proprietary study done by Morgan Stanley that talks about consumer attitudes on snack foods. That's useful in assessing companies such as PepsiCo.

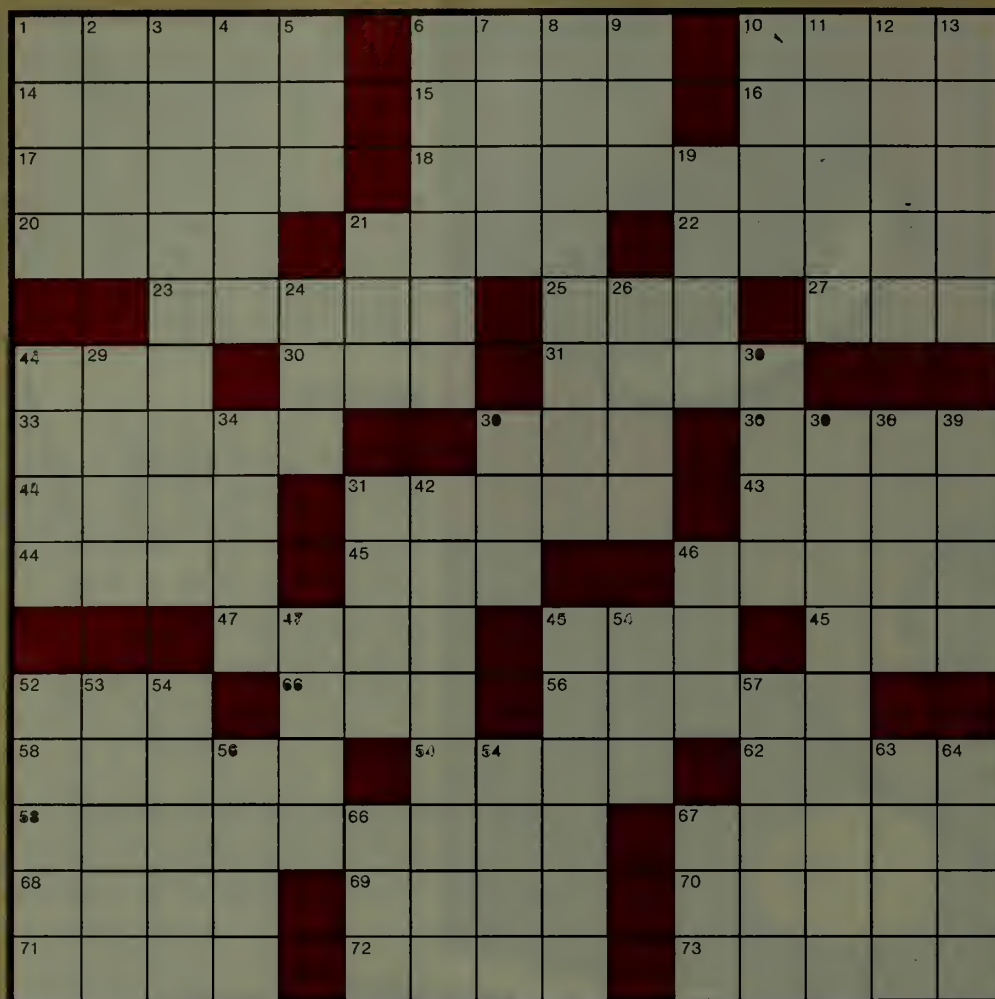
Exhibit 9

Consumer Attitudes Toward Snacks Turning Healthy

	% Consumers
I enjoy salty snacks	53%
I enjoy sweet snacks	52%
I try to avoid unhealthy snacks	42%
I see no change in my snacking habits	40%
I plan to eat more snacks that have a nutritional benefit (calcium, vitamins added)	30%
I plan on eating more reduced/low fat versions of my favorite snacks	29%
I plan on eating more granola, oatmeal or cereal bar snacks	18%
I'm snacking more often in place of sit-down meals	12%
I plan on eating more energy bars	10%
I plan on eating more organic snacks	10%

Source: Morgan Stanley Consumer Research

Mixing Business with Pleasure by Lincoln



ACROSS

1. Mutual-fund sales charges
6. Sales staff
10. Starting
14. Big name in aluminum
15. Goes wrong
16. Citrus fruit
17. Entrain
18. Wrote off gradually
20. Tart-tasting
21. Shut forcefully
22. Prolonged attack
23. Cash or land
25. "Alley ___"

27. Wind instrument
28. Play about robots
30. Frosty
31. Prepare a salad
33. UMW or NEA
35. Shriner's topper
36. Name of 12 popes
40. Brainstorm
41. Piece of the pie
43. Useful data
44. Snack
45. Auction item
46. Diplomatic agent
47. Part of BTU
49. Sheep sound

51. Curved letter
52. Mandela organization: Abbr.
55. Shelley selection
56. Senator Hatch
58. Versace headquarters
60. Enumerate
62. Cooking direction
65. Adam Smith, for example
67. Unanimously
68. Parade feature
69. Presidential prerogative
70. Burst of voltage
71. Fruit drinks
72. Household appliance
73. Typed, with "in"

DOWN

1. Falls behind
2. Butter alternative
3. Premium calculators
4. They may be revolving
5. ___ Joaquin Valley
6. Land, homes, etc.
7. Humorist Bombeck
8. PR person, often
9. Ukraine, formerly: Abbr.
10. Et ___ (and others)
11. "Magnificence comes in all ___"
(see page at right)
12. Alpha's opposite
13. DHL competitor
19. Recipe quantities: Abbr.
21. Harvey Pitt's agency: Abbr.
24. Sermon topic
26. Seep out
28. Bring down
29. Bring down
32. Specialty of a certain "doctor"
34. Popular vacation spot
35. Budgetary excess
37. What LIFO may be used for
38. Sci-fi vehicles
39. Popular beans
41. Declined
42. Bill Marriott, for instance
46. Musical ability
48. It's prohibited
49. Fidelity's home
50. Matisse piece
52. Tiny animal
53. Type of battery
54. "___? No." (see page at right)
57. Something to debate
59. "No ifs, ___ or buts!"
61. Ratio phrase
63. "Picnic" playwright
64. Grass stalk
66. DIII doubled
67. Bid's opposite

For answers to this puzzle:

Turn to page 149 in this week's issue of BusinessWeek or access Mixing Business with Pleasure by Lincoln through any PDA*. Visit businessweek.com/lincoln/ and enjoy 8 puzzles over the next 2 months.

Puzzle created by: Stanley Newman.

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MORE PROMINENT DISCLOSURE

Wall Street firms have begun to flag potential conflicts arising from their investment banking relationships. A disclaimer like the one above might make you want to seek another source.

an analyst report, make believe you're a juror sitting in a jury box and you're listening to a lawyer giving a summation," says Marc Gerstein, director of investment research at Multex, which sells analyst reports at Multex.com.

Try comparing arguments from different analysts. The controversial Jack Grubman, while still at Salomon Smith Barney, lauded WorldCom in January, 2001, saying: "We continue to believe

consumers showed a shift toward healthy snacks—a trend that could help PepsiCo brands such as Quaker Oats, Tropicana, and Dole. Not that you have to buy the analyst's argument. "When you're reading

the firm doing the rating and the company being evaluated. Some firms are adding disclosures of their own. Merrill Lynch, for instance, now prominently displays a warning on the cover page of its reports telling investors that the firm may seek investment banking business with the companies being analyzed. Maybe you'd rather seek a report on that company from a firm that doesn't need to make that disclosure.

In another new type of disclosure, Banc of America Securities revealed in a recent report that 95% of its buy recommendations went to companies it had received investment banking money from in the past 12 months. That could be a tip-off to look elsewhere for opinions on stocks. Some firms, such as A.G. Edwards, have little investment banking business, and research companies such as Value Line, Morningstar, and Standard & Poor's have none. (S&P, like *BusinessWeek*, is a unit of the McGraw-Hill Companies.)

Paying close attention to the language of a report is critical. Even the now-pilloried Henry Blodget—onetime superstar Internet analyst at Merrill

Q&A

WHY T-BONDS ARE RISKY



Investors have long prized U.S. Treasury bonds because of their liquidity and pristine credit quality. But now they could be risky holdings, says

Donald Cox, chief

strategist at Harris Investment Management, a Chicago firm that oversees \$17.5 billion in assets. Cox recently spoke with Personal Finance Editor Susan Scherrek:

Q: Why are Treasuries risky?

A: Over the past six months, Treasuries maturing in 10 or more years haven't been influenced by inflation expectations and economic data—things that primarily move bonds. Instead, Treasury prices have moved in the exact opposite direction of stock prices. That rarely happens and it has created distortions in the bond market.

Q: What has caused this?

A: During a bear market, it's normal for some investors to flee stocks for the safer haven of bonds. Hedge funds have profited from this trend by selling stock futures contracts while at the same time buying futures contracts on Treasuries. That trading strategy has pushed Treasuries' yields to levels lower than they ought to be.

Q: What should Treasuries yield?

A: The key bond—the 10-year Treasury—recently yielded 4%, which is far too low with U.S. inflation in the 2% range. If Treasuries were behaving more normally, yields would be nearly one percentage point higher.

Q: Which means?

A: When the stock market revives, investors will shift to equities, causing Treasury yields to rise and prices to fall.

Q: What should investors do?

A: Buy corporate bonds, which are trading at historically high yields to Treasuries because of these distortions, not because Corporate America is doing badly.

Rating Distribution

US Coverage Universe	Companies	Percent	Investment Banking *	Companies	Percent
Buy	406	54	Buy	384	95
Hold	336	45	Hold	291	87
Sell	12	2	Sell	9	75

* Companies BAS has received compensation from in the past 12 months. As of 10/01/2002.

ABOUT THOSE RATINGS

Investment firms now must show how they allocate buys, sells, and holds. The table above, from Banc of America Securities, says that only 54% of stocks got a buy, but 95% of the buys went to banking clients.

f their households from maintaining a

wcom Group will meet or beat expectations." Meanwhile, rival Daniel Reingold of Credit Suisse First Boston gently warned investors away, citing the company's "very high exposure to LD [long distance]... amidst a very uncertain LD pricing environment." This past July, WorldCom became the largest Chapter 11 bankruptcy ever.

Even those suspect analyst buy/sell recommendations may become more realistic. New SEC rules require securities firms to define their ratings and tell investors what percentage are buys, holds, and sells—or their equivalents. Other rules increase disclosure of investment banking connections between

based on an optimistic earnings projection, was a stratospheric 578. "The stock is very expensive on all traditional metrics and, hence, is likely to remain volatile," he wrote. That's not as good as a sell, but it's a warning you wouldn't have gotten without reading the fine print.

Technology Buying Guide

Introducing the Technology Buying Guide Directory – a showcase of technology products and services available this holiday season.

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Throw Me In, Coach

If you want to swim your way to fitness, it may be time to retool your stroke. **BY KATE MURPHY**

BAD FORM. IT'S WHAT prevents many people who otherwise enjoy swimming from doing it to stay fit. "Their technique is so poor, they can't get a good workout," says Ellis Peters, the swim coach at the 92nd Street Y community center in New York. Indeed, even those who can easily run several miles have trouble swimming just a few laps because of inadequate breathing or an awkward stroke.

Relearning how to swim may be the answer. A good coach who teaches adults at your health club or local YMCA can show you how to sustain your swim session long enough to raise your heart rate, burn calories, improve flexibility, and build strength. The instructor can also help you devise workouts that isolate muscle groups using fins, paddles, and buoys. Plus, learning correct form reduces the chances of injuries to the shoulders, hips, and back.

WAITING TO EXHALE

Don't be surprised if you feel like a beginner again. The ideal freestyle or front crawl stroke has changed over the past 20 years, with more emphasis on whole body rotation. The old school taught swimmers to keep their body flat and fixed, but now experts say it's better to turn and sway with the movement of your arms. This enhances your speed and prevents wear and tear on your joints.

Another common error in form is holding your head up to look where you are going rather than keeping your head down and eyes fixed on the bottom of the pool. This strains your neck and causes your back end to sink. And you don't want to inhale and exhale when you take a breath. It's bet-

ter to exhale slowly into the water while your head is submerged so you only have to inhale when you come up for air. That way you take in the maximum amount of oxygen.

Kicking at the knee instead of using your entire leg wastes energy, diminishes buoyancy, and can cause injuries. Alone or in combination, these mistakes can make you feel as if you are fighting your way through the water. The goal is "not to set the water in motion but to have the water set you in motion," says Dave Holland, swim coach at Randolph Macon College in Ashland, Va., who teaches adult clinics in the summer.

More health clubs and aquatic centers are adding adult swim instruction. Finding a teacher in your area is easy thanks to the online resource ClubSwim.com. If your Y has a pool, it's a good bet it offers adult lessons (ymca.net). You might also consult the Web site for United States Masters Swimming (usms.org), which has more than 1,100 workout groups nationwide. Despite its elite-sounding name, Masters groups welcome swimmers of all abilities. Finally, find a pool where you can swim year-round. In swimming, you get rusty by staying out of the water.



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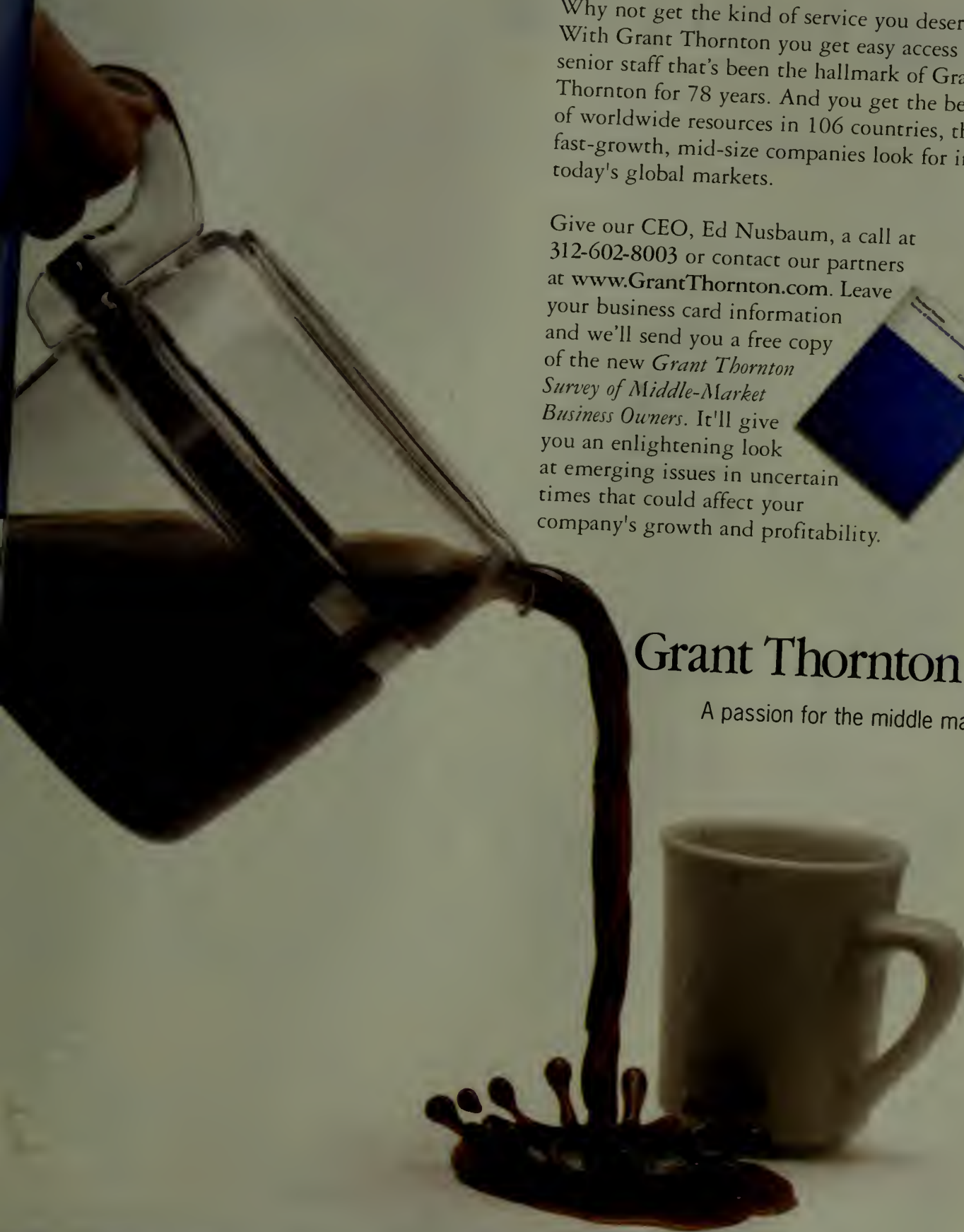
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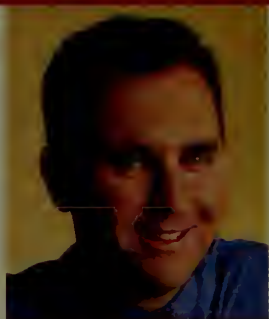
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Grant Thornton

A passion for the middle market





SO YOU THINK STOCK PICKING IS A FOOL'S GAME

BY ROBERT BARKER rb@businessweek.com

D-F-A ARE THREE LETTERS that, put together, have meant little to most individual investors. That's changing, and odds are rising fast that if you talk with a financial adviser, you'll hear about DFA. Short for Dimensional Fund Advisors, DFA is a California firm whose office overlooks the Pacific from a neat perch on the bluffs at Santa Monica. It's filled with a flock of efficient-market types, including the University of Chicago's Eugene Fama, who first proposed the efficient markets hypothesis (that is, that stock prices swiftly and correctly reflect information, making attempts to beat the market the work of fools).

DFA manages most of its \$32 billion for such giant investors as pension funds. It won't deal with you and me, at least not directly. But its business with some 500 independent financial advisers, who funnel money from individuals to DFA, is surging. These assets now come to more than \$12 billion. To the right ears—those on anyone who doubts the value of stock picking or market timing—DFA is an easy sell. It holds that portfolios built with DFA funds and tilted toward the small-cap and value stocks that Fama and other researchers favor offer the best risk-return trade-off. As Gregg



Fisher, president of Manhattan financial planners Gerstein Fisher & Associates, put it, "Hearing Eugene Fama speak it's like watching Babe Ruth play baseball."

Despite its passive approach, DFA follows no index. So, for example, its small-cap portfolios are traded daily according to DFA's own criteria for what makes a good small-cap stock, such as market value and liquidity. Not having slavishly tracked, say, the Russell 2000 index gives it flexibility to keep a sharp focus on the small-cap end of the market. DFA also slices markets in any exotic way that allows it to grab a position—emerging markets value stocks, for instance—whose risks and returns seem to differ from every other portion. These distinct asset classes then can be put together in portfolios of varying levels of risk. As it happened in the five years ended Sept. 30, a 15-fund DFA portfolio, 60% in global stocks, 40% in global bonds, would have returned an annual average of 3.3%. By contrast, a benchmark with a 60-40 mix of domestic stocks and bonds returned 2.3% a year.

What's the hitch? First, consider that just because small cap and value stocks have done better before is no guarantee they will again. "There's no reason to suspect that any one segment of the market will do substantially better than any other part," Vanguard Group's indexer-in-chief, Managing Director Gus Sauter, told me. Also, individuals can't buy DFA except via an adviser. That means extra annual fees. A hypothetical DFA portfolio might cost 1% of assets a year—far less than the average mutual fund, yet far higher than other options (table). While DFA suggests its long-term returns will outstrip an adviser's fee, any do-it-yourselfer with discipline might approximate a DFA portfolio more cheaply.

The key word is discipline. Fisher said his big challenge is convincing clients that once you create an asset allocation, it's best to do nothing. Do your portfolio moves seem too frequent and leave you queasy? Then D-F-A may spell relief. ■

COMPARING COSTS: DFA VS. COMPETITORS

If you invested \$1 million in a tax-deferred account with Dimensional Fund Advisors, what would it cost? And how would that compare with building a comparable portfolio on your own, using Barclays iShares exchange-traded funds or Vanguard Group funds?

ASSET CLASS (% OF PORTFOLIO)	BARCLAYS ISHARES NO. OF FUNDS/ ANNUAL COST	DFA FUNDS NO. OF FUNDS/ ANNUAL COST	VANGUARD FUNDS NO. OF FUNDS/ ANNUAL COST
U.S. Stocks (42%)	5/\$804	5/\$1554	5/\$972
International Stocks (18%)	2*/\$750	6/\$1414	2/\$744
Fixed Income (40%)	2/\$600	4/\$990	2/\$1200
Total fund expenses	\$2,154	\$3,958	\$2,916
Advisory Fee or Commissions	\$65	\$6,000	\$0
Total Cost	\$2,219	\$9,958	\$2,916
Total cost as % of assets	0.22%	1.00%	0.29%

*iShares for emerging markets stocks are still in registration with the Securities & Exchange Commission; expense ratio estimated at 0.55%
Data: Company reports, Morningstar, BusinessWeek

BusinessWeek online

For an archive of columns, go to www.businessweek.com/investor/ and click on "Columns"

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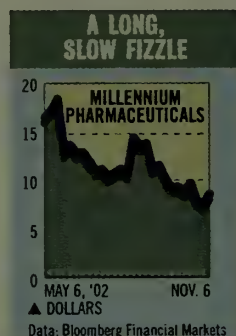


FRESH CANCER TREATMENTS COULD SPARK MILLENNIUM'S STOCK CLASS ACTIONS AGAINST H&R BLOCK MAY NOT AMOUNT TO MUCH SUNCOR SEES A REVIVAL IN CANADA'S VAST OIL-SANDS DEPOSITS.

BY GENE MARCIAL

A New Millennium

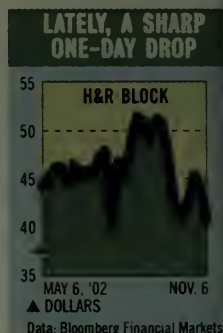
Millennium Pharmaceuticals (MLNM), once a pure play in genomics, has turned into an outfit that commercializes breakthrough drugs and diagnostic products. In February, it acquired COR Therapeutics, whose chief product, Integrilin, an arterial-blood-clot breaker, is expected to produce sales of \$304 million in 2002 and \$350 million in 2003. Integrilin's net value to Millennium is \$1 billion, says Standard & Poor's Frank DiLorenzo. But another product now in Phase 3 trials, Velcade, may really boost Millennium's stock, which, along with other biotechs, has slumped—from 36 a share in early December and 16 in mid-May of 2002, to 8.59 on Nov. 6. Velcade is designed to treat multiple myeloma, or blood-borne cancer. At the Dec. 9 meeting of the American Society of Hematology, Millennium is expected to reveal favorable clinical results for Velcade. Edward Tenthoff of ThinkEquity Partners says that in Phase 2 trials Velcade was found to be "safe and well-tolerated" in 77% of the 70 patients. The drug's efficacy, he says, lasted at least 6.2 months. He adds that the Phase 3 trials, for which 700 patients are enrolled, could show even better results. A more lucrative market for Velcade—possibly worth \$1 billion, says Tenthoff—is in the treatment of solid tumors, for which it is now in Phase 1 trials. He expects Millennium, which has yet to make money, to file for approval of Velcade in 2004. It has a pipeline of compounds in various stages of trials, including therapy for prostate cancer, leukemia, and obesity. Tenthoff, who owns stock, has a target of 15, rates it "overweight" and sees it posting profits by 2004.



H&R Block Is Getting Sued —So the Shares Are a Buy

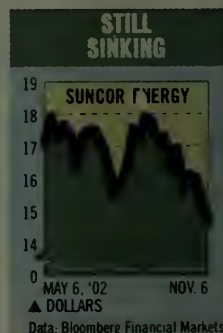
When short-sellers circulated a report on Nov. 1 that H&R Block (HRB), No. 1 in tax preparation, had failed to disclose two lawsuits it was facing, the stock dropped from 44 to 40 in a day. Enter the bargain hunters, who love H&R's noncyclical tax business, which accounts for 60% of company revenues and 65% of earnings. "This is a buying opportunity for this high-quality growth stock," says Chris

Gutek of Morgan Stanley, who rates the stock "overweight." Morgan did banking for H&R in the past year. The class actions, filed in 1996, relate to H&R's "refund anticipation loans," made in partnership with Household Bank and offered to customers awaiting a refund. The suits allege that H&R charges excessive interest rates that violate consumer-finance laws. Since 1990, more than 20 suits have been brought against H&R, but it says it hasn't lost once. Although it denies violating any laws, in 1999 H&R offered to settle outstanding suits for \$25 million. But the Court of Appeals rejected the settlement and remanded the case to the District Court that had approved it for further consideration. Even if the proposed settlement is increased, "it won't be material to Block," says Michael Millman of Salomon Smith Barney, who rates the stock an "outperform," with a price target of 66. He sees H&R earning \$3.01 a share in 2003 and \$3.41 in 2004. It made \$2.31 in fiscal 2002 ended Apr. 30.



Bursting with Energy At Suncor

Oil stocks are on the skids as crude prices slip. But investment pro Robert Stovall of Clemente Capital insists the way to go is Suncor Energy (SU), an integrated company that owns 100% of a profitable oil-sands operation in Canada. He does not see the stock, which has sunk from 18 in August to 14.95 on Nov. 6, as a run-away—but Stovall says it could rise to 20 in a year. Also high on Suncor is ace oil analyst Charlie Maxwell at brokerage Weeden & Co., who forecasts earnings of 95¢ a share in 2002 and \$1.40 in 2003, vs. 50¢ in 2001. Suncor's economies of scale will allow it to cut production costs from \$8.50 a barrel in 2002 to an estimated \$6.50 in 2003, he says. The oil sands are well defined, Maxwell adds, so exploration costs are low. Robert Plexmar of CIBC World Markets puts Suncor's net asset value at 30 a share, assuming a long-term oil price of \$20 a barrel.



BusinessWeek online Read Gene Marcial's Inside Wall Street Online column Tuesday afternoons at www.businessweek.com/today.htm. And see him Fridays at 1:40 p.m. EST on CNN's *The Money Gang*.

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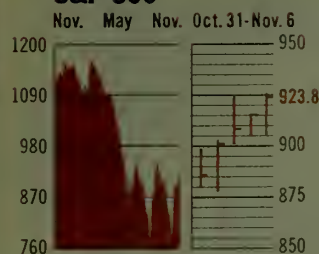
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BusinessWeek Investor FIGURES OF THE WEEK

STOCKS

S&P 500

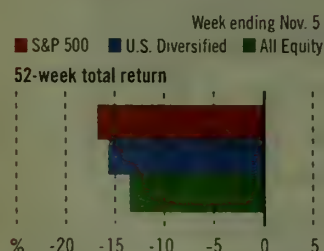
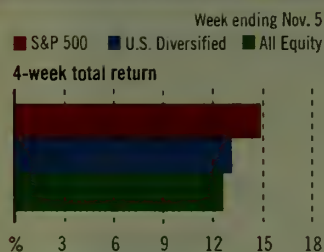


COMMENTARY

The Federal Reserve's surprise half-point rate cut—when most pundits were betting on only a quarter-point cut—boosted the markets on Nov. 6. The Dow recovered from a midday loss in the first half hour after the news broke, closing up 93 points. The market had already been on a roll and ended the week higher. NASDAQ, the Dow, and S&P 500 rose 7.0%, 4.1%, and 3.7%, respectively.

Data: Bloomberg Financial Markets (Reuters)

MUTUAL FUNDS



Data: Standard & Poor's

THE WEEK AHEAD

RETAIL SALES *Thursday, Nov. 14, 8:30 a.m. EST* ▶ Retail sales most likely rose 0.2% in October. That's based on the median forecast of economists surveyed by MMS International. In September, a sharp drop in vehicle sales led to a 1.2% decline in sales. Excluding vehicles, October sales probably increased 0.3%, after inching up 0.1% during September.

EXPORT-IMPORT PRICES *Thursday, Nov. 14, 8:30 a.m. EST* ▶ Import prices in October are forecast to have increased by 0.3%. In

September, import prices climbed 0.7%, on a 6% jump in petroleum prices. Export prices in October probably edged up 0.2% for the third straight month.

BUSINESS INVENTORIES *Friday, Nov. 15, 8:30 a.m. EST* ▶ Inventories probably remained unchanged in September, after slipping 0.1% over August.

PRODUCER PRICE INDEX *Friday, Nov. 15, 8:30 a.m. EST* ▶ Producer prices of finished goods most likely increased 0.2% in October,

after edging up 0.1% in September. Excluding food and energy, core prices probably rose 0.1%, after a 0.1% gain in September.

INDUSTRIAL PRODUCTION *Friday, Nov. 15, 9:15 a.m. EST* ▶ Factory output in October probably fell 0.3%, after a 0.1% decline in September. The average operating rate most likely eased to 75.8%, after slipping to 75.9% in September. Slack capacity and global economic weakness continue to weigh on manufacturers.

U.S. MARKETS

	NOV. 6	WEEK	% CHANGE YEAR TO DATE	LAST 12 MONTHS
S&P 500	923.8	3.7	-19.5	-17.4
Dow Jones Industrials	8771.0	4.1	-12.5	-8.6
NASDAQ Composite	1419.0	7.0	-27.2	-22.7
S&P MidCap 400	439.1	3.3	-13.6	-6.9
S&P SmallCap 600	200.8	3.5	-13.5	-4.2
Wilshire 5000	8708.9	3.8	-18.7	-15.5

SECTORS

			% CHANGE YEAR TO DATE	LAST 12 MONTHS
BusinessWeek 50*	580.6	2.1	-20.5	-20.5
BusinessWeek Info Tech 100**	302.4	5.4	-27.9	-24.6
S&P/BARRA Growth	476.9	3.5	-19.8	-17.9
S&P/BARRA Value	443.6	3.9	-19.6	-17.5
S&P Energy	184.6	2.3	-12.6	-10.8
S&P Financials	311.2	2.1	-12.4	-9.9
S&P REIT	90.2	3.6	-3.5	0.6
S&P Transportation	174.9	4.9	-11.2	-3.6
S&P Utilities	97.7	5.3	-33.1	-35.9
GSTI Internet	83.0	8.4	-20.9	-7.5
PSE Technology	485.2	7.9	-29.4	-25.9

*Mar. 19, 1999 = 1000

**Feb. 7, 2000 = 1000

GLOBAL MARKETS

	NOV. 6	WEEK	% CHANGE YEAR TO DATE
S&P Euro Plus (U.S. Dollar)	859.6	5.7	-20.1
London (FT-SE 100)	4103.7	2.5	-21.1
Paris (CAC 40)	3212.9	4.2	-30.1
Frankfurt (DAX)	3298.8	6.0	-36.1
Tokyo (NIKKEI 225)	8953.3	2.2	-15.1
Hong Kong (Hang Seng)	9774.0	2.2	-14.1
Toronto (S&P/TSX Composite)	6437.9	1.7	-16.1
Mexico City (IPC)	6064.0	1.7	-4.1

FUNDAMENTALS

	NOV. 5	WK. AGO
S&P 500 Dividend Yield	1.72%	1.78%
S&P 500 P/E Ratio (Trailing 12 mos.)	29.8	28.4
S&P 500 P/E Ratio (Next 12 mos.)*	16.6	16.1
First Call Earnings Revision*	-2.82%	-3.03%

*Firm

TECHNICAL INDICATORS

	NOV. 5	WK. AGO
S&P 500 200-day average	1000.2	1006.0
Stocks above 200-day average	24.0%	20.0%
Options: Put/call ratio	0.72	0.75
Insiders: Vickers NYSE Sell/buy ratio	1.58	1.53

BEST-PERFORMING GROUPS

	LAST MONTH %	LAST 12 MONTHS %
Internet Software	86.1	Casinos 37.6
Wireless Services	74.1	Metal & Glass Containers 34.0
Office Electronics	58.6	Internet Software 33.8
Computer Stge. & Perphs.	54.7	Photographic Products 33.4
Semiconductor Equip.	51.0	Homebuilding 31.2

WORST-PERFORMING GROUPS

	LAST MONTH %	LAST 12 MONTHS %
Health-Care Facilities	-23.6	Multi-Utilities
Tires & Rubber	-9.1	IT Consulting
Commercial Printing	-8.5	Telecomms. Equip.
Computer Stores	-4.6	Wireless Services
Household Products	-1.6	Instrumentation

EQUITY FUND CATEGORIES

4-WEEK TOTAL RETURN	%	52-WEEK TOTAL RETURN	%
LEADERS		LEADERS	
Technology	31.6	Precious Metals	48.6
Communications	28.6	Real Estate	7.9
Financial	15.0	Pacific/Asia ex-Japan	5.4
Europe	14.5	Diversified Emerging Mkts.	4.7
LAGGARDS		LAGGARDS	
Japan	4.5	Communications	-37.6
Diversified Pacific/Asia	4.7	Technology	-35.1
Real Estate	5.1	Health	-25.0
Precious Metals	5.7	Utilities	-24.3

EQUITY FUNDS

4-WEEK TOTAL RETURN	%	52-WEEK TOTAL RETURN	%
LEADERS		LEADERS	
ProFunds UltraWireless	93.6	First Eagle SoGen Gold	75.3
ProFunds UltraSemicondr.	68.0	Tocqueville Gold	63.8
ProFunds UltraOTC Inv.	65.1	Monterey OCM Gold	63.3
Rydex Dynam. Velocity 100	64.6	Gabelli Gold	61.5
LAGGARDS		LAGGARDS	
Rydex Dynam. Venture 100	-43.4	ProFunds UltraWireless	-77.2
ProFunds UltraShort OTC	-43.4	ProFunds UltraOTC Inv.	-62.5
Rydex Dynam. Tempest 500	-26.0	Rydex Dynam. Velocity 100	-61.4
ProFunds UltraBear Inv.	-25.8	ProFunds UltraSemicondr.	-60.8

INTEREST RATES

KEY RATES

	NOV. 6	WEEK AGO	YE
MONEY MARKET FUNDS	1.34%	1.35%	
90-DAY TREASURY BILLS	1.22	1.49	
2-YEAR TREASURY NOTES	1.83	1.74	
10-YEAR TREASURY NOTES	4.03	3.96	
30-YEAR TREASURY BONDS	5.06	5.03	
30-YEAR FIXED MORTGAGE†	6.14	6.07	

†Banks' quoted

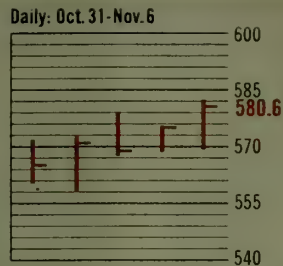
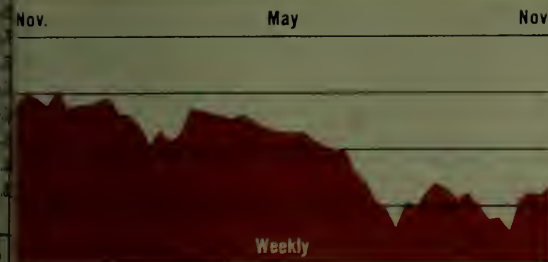
BLOOMBERG MUNI YIELD EQUIVALENTS

Taxable equivalent yields on AAA-rated, tax-exempt municipal bonds, assuming a 30% federal tax rate.

	10-YR. BOND	30-Y
GENERAL OBLIGATIONS	3.81%	4.1
TAXABLE EQUIVALENT	5.44	6
INSURED REVENUE BONDS	3.94	5
TAXABLE EQUIVALENT	5.63	7

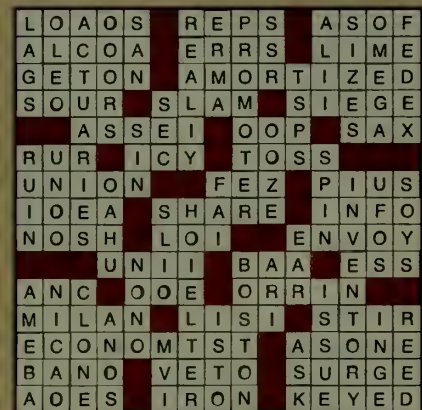
Mixing Business with Pleasure by Lincoln

THE BUSINESSWEEK FIFTY



BW 50 rose 2.1% this week. Calpine soared 81.4% on hopes that its cash crunch is lessening, and an Electric Power rose 10.3%. Washington Mutual, up 2.3% this week and the best performer since debuted, continues to benefit from the ongoing refinancing trend. Tenet Healthcare fell 32.6% on news the government is auditing Medicare payments.

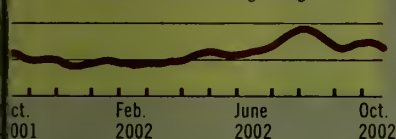
COMPANY PERFORMANCE			% CHANGE			% CHANGE		
COMPANY	WEEK	SINCE 3/1/02	RANK	COMPANY	WEEK	SINCE 3/1/02		
Johnson & Johnson	5.2	-1.0	26	Tenet Healthcare	-32.6	-31.7		
Reddie Mac	1.6	-1.2	27	Household International	7.1	-51.5		
Pfizer	5.0	-17.9	28	WellPoint Health Networks	-0.8	28.1		
BNA	7.4	-6.5	29	Washington Mutual	2.3	11.7		
Philip Morris	3.4	-20.5	30	Duke Energy	8.4	-38.1		
LA-Tencor	7.7	-32.5	31	Kohl's	5.1	-11.4		
Annie Mae	0.8	-12.8	32	Bed Bath & Beyond	-1.0	5.1		
Qwest	-3.1	-8.0	33	Cardinal Health	0.3	5.9		
Best Buy	-9.5	-56.2	34	Centex	6.6	-17.9		
MerisourceBergen	-2.7	5.4	35	American Electric Power	10.3	-34.8		
UnitedHealth Group	-0.8	30.4	36	Golden West Financial	0.7	9.0		
Xcel	4.2	6.6	37	Stryker	6.6	7.7		
Home Depot	-4.0	-43.4	38	Harley-Davidson	0.5	4.2		
Wal-Mart Stores	1.0	-12.4	39	PepsiCo	-0.6	-13.8		
Wynegy	-3.8	-97.0	40	Merck	3.2	-8.7		
General Dynamics	3.8	-9.7	41	Apache	0.2	3.3		
MonocoPhillips	-0.3	-17.1	42	Amerada Hess	1.5	-25.2		
Forest Laboratories	2.2	27.2	43	KB Home	3.0	8.0		
Lock (H&R)	-6.9	-18.7	44	First Data	7.0	-9.0		
Calpine	81.4	-50.9	45	Tyco International	8.0	-45.3		
Occidental Petroleum	-0.3	5.1	46	International Game Technology	-1.6	11.6		
YSCO	-0.7	7.9	47	Capital One Financial	5.5	-32.9		
Waste Homes	6.2	-8.2	48	Electronic Data Systems	22.2	-71.5		
Marathon Oil	0.9	-23.7	49	Nabors Industries	9.8	9.6		
Itigroup	2.2	-10.7	50	Xcel Energy	5.0	-52.5		



W PRODUCTION INDEX

Change from last week: -0.5%
Change from last year: 1.9%

INDUSTRIAL OUTPUT Oct. 26=163.1 1992=100
The index is a 4-week moving average



Production index declined. Before calculation of the 4-week moving average, the index fell for the fourth period to 163.1 from 164. On a seasonally adjusted basis, rail freight suffered the largest fall on a broad down in traffic. Truck assemblies, coal, and lumber also fell lower. On the plus side, autos showed a big bounce, led by electric-power production and crude-oil refining. Gas little changed for the week. The index in October fell to 163.1 from 164 for all of September.

For more information on each of the index components is at www.businessweek.com.
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For more investment data and the components of the production index, visit www.businessweek.com

Answers from this week's puzzle in BusinessWeek.



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WHAT VICTORY MEANS FOR THE GOP

The Republican sweep of both chambers of Congress sets the stage for a bolder GOP agenda. The big personal win for President Bush gives him momentum, if not a mandate, to go forward with his domestic and international priorities on taxes, Iraq, and homeland security. How far he goes in the next two years will largely depend on the prosecution of a possible war with Iraq and the strength of the economic recovery. It will also depend, in part, on how the Democratic Party reconstitutes itself in the face of defeat.

The danger now facing the Republicans is overreach. The economy, and the nation, will require a carefully balanced package of policies in the near term. The end to divided government may raise expectations beyond the limits of what can be accomplished. However great the Republicans' midterm political victory, the majorities in the Senate and House of Representatives are still narrow. President Bush would be wise to reach out to moderates in his own party and among the Democrats in seeking to implement his agenda. The simple truth is that the economic recovery is wobbling and faces unusual uncertainties from a looming war abroad and terrorism at home. However difficult it may be, a bipartisan stimulus package by spring will probably be needed to keep the economy growing. President Bush would also do well to follow through on his multilateral course of working through the U.N. to build an international coalition against Saddam Hussein. It is the best way to rid Iraq of weapons of mass destruction while avoiding a Middle Eastern backlash that could jack up the price of oil and jeopardize the recovery.

THE ECONOMY NEEDS A BOOST

We have a few suggestions on how the President should proceed. The economy needs a serious insurance policy against another downturn. The Federal Reserve helped out on Nov. 6 by cutting interest rates by 50 basis points, but a strong fiscal boost is needed as well. The President will be tempted to follow up on his party's victory by trying to make the \$1.3 trillion income- and inheritance-tax cuts permanent. He shouldn't. What the country needs now is immediate stimulus, and accelerating both the 2004 and 2006 income-tax cuts to 2003 does just that.

But the prudent course is to wait to implement the later income-tax cuts. Remember, the surplus revenue projections behind the big tax cuts made in 2000 were based on a high-tech bubble that has since burst. It may be that the stock market will soar high enough once again to generate the kind of tax revenues from capital gains that we saw in the '90s, but it is doubtful. And stock options are on their way to being expensed, which will cut income-tax revenues. If the economy and stock market grow fast enough to allow them, fine. But we should be prepared to pull the outyear tax cuts back to pay for higher defense and other spending needs. It also makes sense to cap the limit for exempting the inheritance tax at \$5 million. That would allow nearly all fam-

ilies and owners of small businesses and farms to pass their inheritance. Above that, the estate-tax exemption becomes a gargantuan benefit for a few thousand people. The GOP proposals to end the double taxation of dividends and to limit the liability to asbestos lawsuits should also be on the table. They can help investment and investors.

PRAGMATISM, NOT IDEOLOGY

The Democrats lost soundly in the midterm elections because their economic message to the voters was off-kilter. First, they obsessed about fiscal restraint and balancing the budget—a Hoover-like position that makes little economic sense in the face of today's slow growth and deflation. Then they misjudged the economy by running a Rust Belt type campaign emphasizing safety-net issues for blue-collar workers at a time when the classic "misery index"—the combined unemployment and inflation rate—has remained low.

But President Bush should consider some Democratic proposals, such as extending unemployment insurance, helping strapped states with more federal money, and cutting taxes for low-income workers. No one knows how the war on Iraq is going to play out or what its impact on the economy will be. Corporate America's drive to boost profits will probably send unemployment significantly higher in 2003. War uncertainty could cut consumer spending and business investment as well, causing job loss. Next year will prove crucial for President Bush's bid for another term in 2004. A spike in the misery index could put a spike in his campaign. Adopting some safety-net provisions not only makes economic sense for Bush but political sense as well.

The Republican victory will finally get Congress to pass the President's Homeland Security Act. It's about time. A recent Council on Foreign Relations report shows that little has been done to prepare America for another terrorist attack. Firefighters and police, for example, still cannot talk to each other over the same radio frequency in U.S. cities. One way to pay for security would be to reduce the huge 10-year \$182 billion agricultural subsidy program passed to attract Midwest farm votes. Such subsidies also hurt the GOP's own ideological stands on free trade and corporate welfare.

Finally, the GOP victory will no doubt tempt President Bush to back off on his Administration's drive to reform accounting, corporate governance, and conflicts of interest on Wall Street. Much progress has been made in punishing wrongdoers, but it would be a mistake to think that only a few rotten apples are to blame. Serious systemic problems led to the corruption and scandals. If the Securities & Exchange Commission doesn't finish the job, then New York Attorney General Elliott Spitzer and 49 other state attorneys general will try to do so.

Congratulations to the President and his party on their political victory. They ran a pragmatic campaign. Now they should run a pragmatic economic policy.

BusinessWeek

BER 25, 2002

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ECONOMY

ING RIGHT ULUS

ROPE

EU: IGGER TER?

ENDING BATTLE FOR A RADICAL PLANE

NCER

HOPE, HYPE, REALITY

WILL SUN RISE AGAIN?

**Scott
McNealy
has a grand
plan. But
it's risky,
and time
is running
short.** PAGE 120

PAGE 120

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Sun Microsystems is on the ropes. The computer maker is losing money, its shares have plunged, and top managers have jumped ship. Yet CEO Scott McNealy is convinced that the formula of stubbornness, hard work, and innovation that kept Sun on top for years will come to the rescue. There's no time to waste

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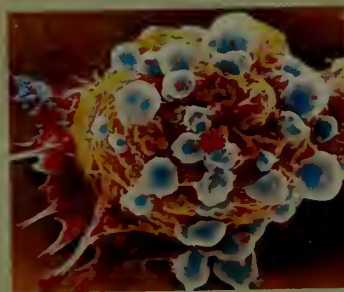
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A PC Rebound?

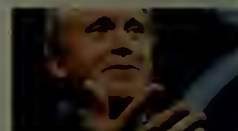
While 2003 isn't likely to see a boom, this Special Report explains why next year should offer a marked improvement for this beleaguered tech sector. Plus: Microsoft's weakened PC sales punch, and more



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Up Front

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SHERIDAN PRASSO

LAWSUITS

THE SKELETON IN FRANK ZARB'S CLOSET

ON THE LIST OF CANDIDATES TO replace Harvey Pitt at the Securities & Exchange Commission (page 51) is Frank Zarb. He has quite the résumé: former chairman of the National Association of Securities Dealers (NASD), former chairman and CEO of Smith Barney, and head of the Federal Energy Administration under President Ford. But a little-known \$6 million fraud judgment in a New Jersey court could throw cold water on his chances in these scandal-sensitive times.

At issue: Zarb's statements in 1996, when, between stints at Smith Barney and NASD,



he was CEO of insurance broker Alexander & Alexander Services. Zarb had helped recruit Philip McConkey, a former pro-football player and top insurance salesman, with assurances that the company was not for sale. However, proxy statements revealed that Zarb was in merger talks with Aon Corp. at the time. The court found Zarb to have shown "wanton and

TALK SHOW "I hit my head, and when the stars stopped, said: 'Is someone trying to tell me something?'"

—William Webster, commenting to The Wall Street Journal about being thrown from his horse as he was considering whether to resign from the Public Company Accounting Oversight Board

THE FEDS

A BITTER PILL FOR BIOTECH

THE BIOTECH INDUSTRY is fuming over a Nov. 1 ruling by the Health & Human Services Dept. on reimbursements from Medicare. A tiny provision of the ruling, stemming from a nasty fight between Johnson & Johnson and biotech giant Amgen, could have consequences for the entire industry. Biotech execs say the new rules could hurt their ability to recoup costs incurred over many years developing drugs. One angry exec says this could "absolutely kill innovation in America."

Here's the root of the anger: In July, Amgen got the O.K. for broader use of an improved version of its blockbuster anti-anemia drug, Epogen. Called Aranesp, the drug will go head-to-head with an older, J&J-marketed version of it, called Procrit. But J&J

persuaded the government to declare both drugs "functionally equivalent," even though Aranesp doesn't need to be given as often. That means Medicare will pay only about half Amgen's price for Aranesp. So, Amgen fears that doctors will use the older, cheaper Procrit instead.

Amgen says it will file suit seeking to overturn the provision.

John Carey



AMGEN'S NEW DRUG Worth it?

willful disregard" for McConkey, who was laid off when A&A was acquired seven months later. It ordered Aon to pay McConkey \$6 million. Zarb says he has no comment. Aon is still appealing.

These days, a court finding of deceitful practices won't do much for anyone's job chances in Washington.

Christopher Palmeri and Mike McNamee

HIGH TECH

THIS YEAR, IT'S COMDEX LITE

COMDEX, THE U.S. tech industry's biggest trade show, kicks off on Nov. 16 in Las Vegas. But this year's fest won't be the extravaganza of bygone years.

Sure, the tech wreck means there will be less than half as many exhibitors as in 2000. But it appears that the company running the show is in deep trouble, too. Key3Media Group, based in Los Angeles, lost \$21 million on revenues of \$252 million



PURPLE HULA: Seeking bygone hoopla

last year, and prospects are looking bleaker this year. Key3 has been delisted from the New York Stock Ex-

change—shares trade at 2½¢.

And it gets worse: Six of Key3's 12 board members, including wealthy investor John Pritzker, have resigned in the past few months. The company already had lost several experienced trade show execs after CEO Fredric Rosen moved the headquarters from Massachusetts to California two years ago.

Rosen blames the slowdown in tech and travel. He says he plans to restructure up to \$370 million in debt and has not ruled out bankruptcy. "When the industry contracts, we get squeezed," he says. Meantime, Comdex-goers will be wishing they could party like it's 1999.

Christopher Palmeri

THE LIST ALPHABET SOUP FOR ACCOUNTANTS

With accounting scandals in the headlines, new "definitions" of common financial acronyms are circulating online. Here are some samples:

CEO

Chief Embezzlement Officer

CFO

Corporate Fraud Officer

EBIT

Earnings Before Irregularities & Tampering

EPS

Eventual Prison Sentence

NAV

Normal Andersen Valuation

P-E

Parole Entitlement



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Up Front

SOFTWARE HARDBALL

DARK DAYS FOR DIRTY MONEY

BEFORE THE SEPTEMBER 11 terrorist attacks, mobsters could take their pick of financial institutions for laundering ill-gotten gains. Those days are over. Now, thanks



to the USA Patriot Act, not only banks, but insurance companies, brokerages, and investment banks are required to keep an eye out for cash-cleansing chicanery.

That's good news for the software industry. SAS Institute, for example, decided to

jump into an area where only small niche players had previously existed. After releasing its anti-money-laundering software on Sept. 30, SAS immediately logged four sales to large institutions, and it has 25 more in the pipeline. "A huge market has opened up to us," says CEO James Goodnight. Smaller competitor Mantas says it has doubled its client list from 5 to 10 in the past year and expects to double it again.

The software uses complex algorithms to sniff out "smurfing"—when crooks make a series of transactions of under \$10,000 to avoid arousing suspicion. That's what fictional mob wife Carmela Soprano was up to on a recent episode of HBO's *The Sopranos*.

For software makers, this is just the start. The Feds have put casinos on notice that they're next in line for scrutiny. *Steve Hamm*

CORPORATE CULTURE

FACING OUR INNER WEASELS

DILBERT AND THE WAY OF THE WEASEL



SCOTT ADAMS

SHOULD WE BE laughing at Corporate America now, when it's making us cry? Yes, says Scott Adams, creator of Dilbert and author of the just-pub-

lished *Dilbert and the Way of the Weasel*. He spoke with BusinessWeek Books Editor Hardy Green:

Do you see yourself as a reformer of corporate excess?

It's not my mission to make the world a better place—it's to make people laugh. But it's gravy to know

that bosses often pause when they're thinking about rolling out a new program. They have to wonder: "Is this the kind of program that could appear in a Dilbert cartoon?"

DRAWN & QUARTERED

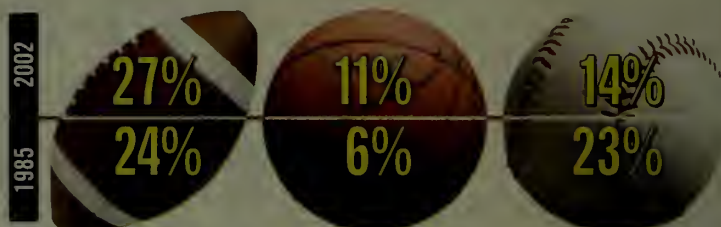
"...other than job layoffs, maxed out credit cards, a stock market that sucks and going to war with Iraq—why do you think consumer confidence is so low?"



BALLPARK FIGURES

COOLING ON THE BOYS OF SUMMER

BASEBALL HAS BEEN LOSING GROUND IN THE POPULARITY contest with football and basketball. Here are the percentages of people who name each as their favorite sport now, compared with 1985:



TELEPHONE SURVEY OF 1,011 ADULTS, RELEASED OCT. 31

Data: Harris Poll

Are executives at Enron and WorldCom "weasels"?

No. The "weasel zone" is that area between good moral behavior and illegality—the zone where most of us operate as we avoid work and

hide our incompetence. Enron executives and others have graduated from this area.

What about your notion of "weasel math"?

It's replacing small numbers with big ones that make you look better. I'm hoping the term will catch on so that when some manager proposes a program backed by inflated numbers, others can say: "Oh, that's weasel math." Then, they can just forget about the proposal.

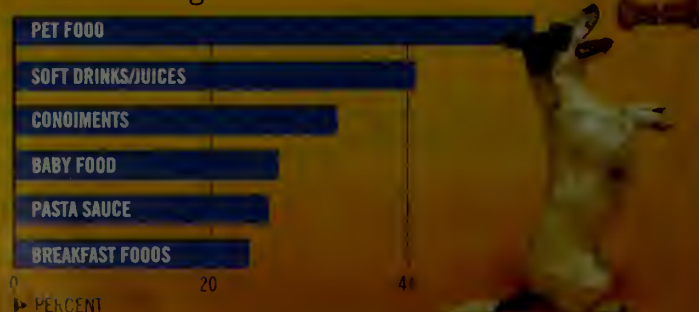
Are accountants, by definition, weaselly?

Wherever there is complexity, there are weasels. Since all of our problems lately are related to accounting, you could say that accountants are the uber-weasels—the ones who started it all. ■

THE BIG PICTURE

BRAND LOYALTY

The share of shoppers who say they are "extremely" or "somewhat" likely to stick with one brand when choosing:



ONLINE SURVEY OF 501 GROCERY SHOPPERS, SEPT. 25-26

Data: Insight Express

Polls, surveys, and other items for consideration in this section should be sent to upfront@businessweek.com

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Cybex, a manufacturer of fitness equipment, uses PeopleSoft Supply Chain Management to drive its forecasting, order management and production processes. Cybex has greatly improved customer service by accelerating the delivery of even highly customized orders. "Increased visibility into manufacturing processes has allowed Cybex to streamline production, reducing make-to-order lead-time by more than 50 percent," says Brian Lyman, Manager of Business Systems. "Improved forecast accuracy also enables us to reduce costs by planning purchases to more closely match demand for each product."

Corning, Inc.

Corning has used PeopleSoft Supply Chain Planning and Manufacturing to connect its operations across four continents. "The expanding presence of PeopleSoft throughout Corning is having an effect on Corning's business culture," says Rick Beers, Director of Supply Chain Technology. "It all comes down to having the right information at the right place at the right time. At Corning, we're starting to use real-time information as a natural extension of ourselves—to make the strategic supply chain decisions that save time and money, enhance customer satisfaction and improve operations."

Aquila Corporation

Aquila Corporation, a multinational energy company serving over six million customers, uses PeopleSoft's Supplier Relationship Management to manage procurement and supply strategies. "We can track our performance from the initial requisition all the way to the back office and identify new opportunities," says Brett Carter, Vice President of eBusiness and Procurement. "By streamlining our supply base and constantly making process improvements, we can reduce the cost of doing business and ultimately save our customers money."

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HOW TO RAISE PROFITS WITHOUT ALL THAT PAIN

I mistrust economists who call for higher levels of unemployment in the absence of inflation ("The painful truth about profits," Cover Story, Nov. 4). The answer to excess capacity is consumption, not "creative destruction." Creating unemployment will only slow consumption and is the worst possible solution to the profits problem. It's so "Hoover."

Andy Johnson
 Mt. Pleasant, S.C.

At a time when we're trying to boost our national spirit and fight terrorism, are employee cutbacks really the way to go? Will they truly boost the stock market? Maybe it's time for corporate leaders to fight to keep our collective mood from disintegrating. How about telling employees, "Hell, no—you won't go!"

Ed LaFreniere
 Clinton, Conn.

I agree with recommendations for higher interest rates, if only because this "poison pill" may just move some CEOs off the dime, toward investing before rates "become worse." The Federal Reserve would not surrender its ability to later buy Treasuries, pushing up their prices. A little money inflation may not offset all asset deflation, but it might prevent worse, particularly if the relative cost of labor could be reduced less painfully. It's worth a try.

Gregory A. Iwan
 Littleton, Colo.

If you probe deeper into operations, as some midsize corporations have

learned to do, there is a better way to targeting profitability. Asset utilization not revenue per employee, is the metric that drives profitability in technology and intellectual-property services businesses. When applied to all types of assets—tangible and intangible as well as financial—corporations directly leverage their total asset base in terms of revenue potential while lowering their cost based on core asset utilization.

This is how corporate profits can be increased on a sustainable basis, jump starting the U.S. and world economies

John G. Carlson, CEO
 System Change Inc.
 Andover, Mass.

The challenges of recession and terrorism have a common theme. In both cases, international coalitions are mandatory, because America is no longer a self-sustaining island of independent action. Either we "bite the bullet" and accept the need for global business consol-

idation, or we endure a protracted economic slowdown, until natural economic attrition does the job for us.

Neale C. Dobkin
 Russell, Mass.

A substantial portion of productivity gains go to customers, not to the bottom line ("Profits: No pain, no gain," Editorials, Nov. 4). Productivity improvements are merely the price of entry into competitive arenas. Longer-term improvements in profitability come from creating value for your customers while keeping a clear eye on your ability to earn more than your cost of capital. Unlike productivity improvements, innovation and outsmart-



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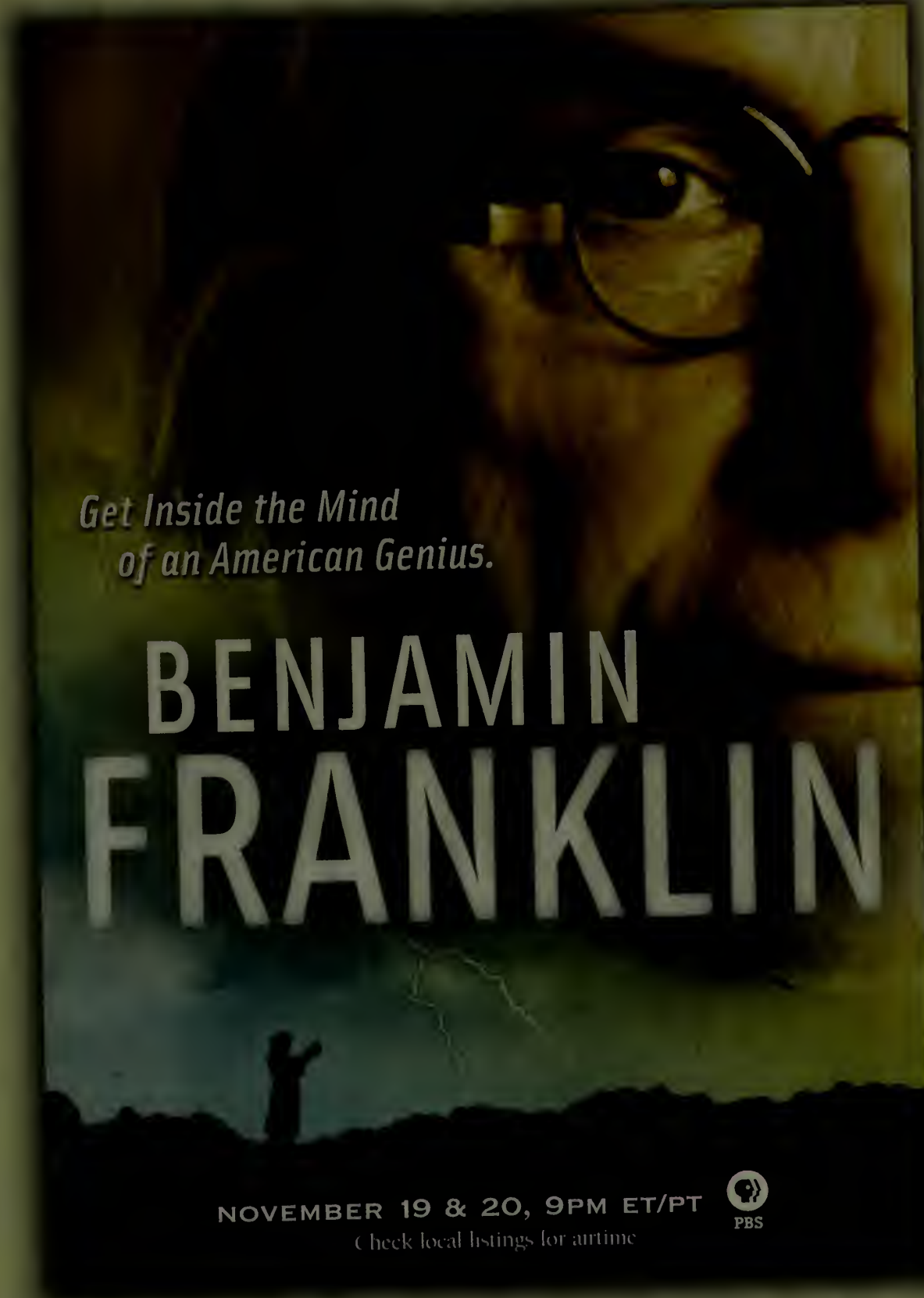
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CORRECTIONS & CLARIFICATIONS

"Chips on monster wafers" (Science & Technology, Nov. 4), the description of the usable area on a 12-inch silicon wafer should have said "up to 2.5 times as much" as an 8-inch wafer.

the competition are not as quickly matched in the marketplace.

Sam Felton
Southwest Harbor, Me.

PEAKING UP FOR PEREGRINE'S ROUDEBUSH

It has been a challenging year being business partner of Peregrine Systems Inc., but David Roudebush has not been part of that challenge ("Did Peregrine bully its partners?" Information Technology, Nov. 4). I have worked with Dave for the past 18 months, and he has been completely honest, courageous, fair, and consistent with us through that time, whether or not it was to the benefit of Peregrine. I cannot speak to the incident in our article, but it is not consistent with the character of the Dave Roudebush I know.

Don Casson
Reston, Va.

AN 'OBSCENE' PAYCHECK FOR THIS HMO BOSS

As a retired pharmacist, I feel the \$58 million paid to Bill McGuire, the CEO of UnitedHealth Group Inc., a company that is supposed to reduce health-care costs, is obscene ("He collects butterflies—and companies," Management, Nov. 4). How can an HMO that restricts its drug formulary to only the brand-name drugs that give rebates reward a CEO who deprives patients of the best treatment?

Bob Cain
Brea, Calif.

GIVE PUBLIC SCHOOLS A BREAK

The entire private-sector school movement is based on the assumption that public education is a profligate waster of money ("Edison: An 'F' in finance," News: Analysis & Commentary, Nov. 4). In reality, public education is one of the best bargains on the planet.

I am a strong believer in the free market. However, private business will

never be more efficient than a public school. School systems must often continue to use buildings, equipment, and books long past the end of their useful lives, and teacher supply budgets are laughable. It's time we quit beating up public schools for their "inefficiency" and "failure," and start acknowledging their success.

Jeff Wig
Brainerd, Minn.

LOSSES IN A WINNING STADIUM

The Cincinnati Bengals' Paul Brown Stadium—a winning workplace? If only that were true ("Winning workplaces," BusinessWeek/Architectural Record Awards, Nov. 4).

Peter Staats
Loveland, Ohio

Editor's note: Through Nov. 10, the Bengals have won 1, lost 8.

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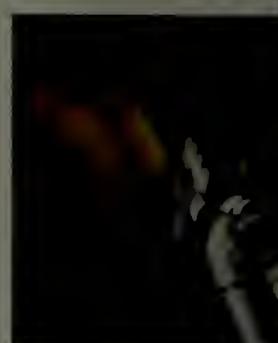
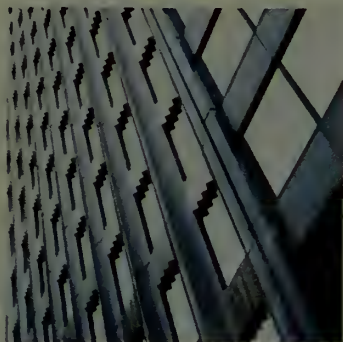
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When you sing to the radio

When you have a backup route

When you use the time to prepare for work

When you use the time to forget about work

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TALES FROM THE BOOM-BOOM ROOM
Women vs. Wall Street
 By Susan Antilla
 Bloomberg Press • 342pp • \$26.95

SEX AND THE STREET

With all the challenges faced by new Smith Barney Chief Executive Sallie L. Krawcheck, there's one she may not have thought of: the firm's reputation, earned in the 1990s, for mistreatment of women. Krawcheck, the former CEO of Sanford C. Bernstein & Co., signed on with the Citigroup subsidiary on Oct. 30. The selection of the highly respected executive is a smart move by Citi CEO Sanford I. Weill, since Smith Barney has become the focus of outrage over the cozy ties between analysts and bankers. However, as Susan Antilla's comprehensive and sharply written *Tales from the Boom-Boom Room: Women vs. Wall Street* reminds us, only six years have elapsed since the firm was regarded as a den of sexism.

Tales traces the story of Pamela K. Martens, a high-producing broker in the Garden City (N.Y.) office of Shearson Lehman Brothers., which merged with Smith Barney in 1994. In 1996, after 11 years of service in that branch, Martens sued Smith Barney, charging a climate of harassment and outright sexual discrimination. Yet Martens didn't win much, and the Street still struggles with discrimination.

Male colleagues were alleged to have established an *Animal House* atmosphere in the office—telling nasty, misogynistic jokes, referring to women as “whores,” and boozing it up in the basement rec area, or “boom-boom room.” Women were banned from off-site meetings such as golf outings, and if they became too successful, their clients were taken away and handed to male brokers. Finally, Martens claimed, women were systematically denied the pay and benefits enjoyed by men.

As more women from Smith Barney and other firms came forward with similar tales—and other lawsuits—the scandal trained nationwide attention on Wall Street sexism. The media breathlessly

repeated tales of how male brokers had tugged at females' clothing, pawed their breasts, and displayed sexual arousal. By 1998, a fired-up New York attorney general, Dennis C. Vacco, was openly criticizing the Street's largest firms and calling for change.

But the brouhaha died down long before the court cases finished. As detailed by Antilla, a Bloomberg News columnist who covered the case for *The New York Times*, Smith Barney proved masterly at undercutting suits and arranging for quiet settlements. Skilled litigators ground down critics, and, according to Antilla, most of the various plaintiffs were dealt with out of court before the original goal of the suit was met: demonstrating patterns of civil-rights violations.

After an eight-month probe, Vacco named only one offender—a mid-level British brokerage. Many of the women who filed claims against employers were driven out of the business, Antilla shows. A few got small settlements, but sizable ones were rare. Many of the men who were named in the suits are still in place.

Among Martens' goals was to end the longstanding practice of requiring employees to arbitrate claims against employers privately, rather than go to court. Yet today, such clauses remain in effect at Smith Barney and elsewhere.

Studies on discrimination and harassment that were compiled as part of the plaintiffs' cases never reached the public. Antilla reports some of that research—and it is damning. According to one psychologist's survey, more than 30% of Smith Barney women were suffering from symptoms of post-traumatic stress disorder. “The rate was high-

er than it was in the military, for God's sake,” psychologist Louise Fitzgerald told Antilla.

The author turns up some outrageous details. For example, at Olde Discount Corp., a family-owned firm that has since been bought by H&R Block, Susan Bell was promoted to branch manager when her male boss quit. She got no raise. And although she was one of the top-earning brokers, her new duties included cleaning the toilets—something not required of her male predecessor. The book reports that the matter was settled out of court.

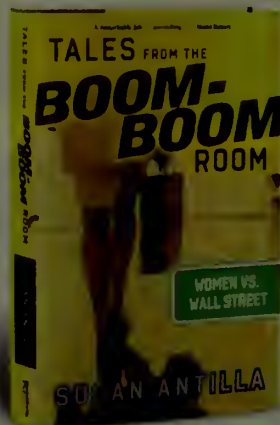
In Antilla's account, the plaintiffs' side doesn't always appear heroic. The lawyers handling Martens' case against Smith Barney—Linda Friedman and Mary Stowell—appear as sitting ducks

for Smith Barney's heavy legal artillery. In Antilla's view, the two naively accepted promises that the firm would change. (The book contains little in the way of a response from the attorneys. According to endnotes, they stopped talking to Antilla for long stretches, and in 2001 they threatened to sue her. Calls from *BusinessWeek* to the attorneys were not returned.)

Smith Barney responded to Antilla's requests for interviews with a letter from its defamation counsel. The company issued this statement to *BusinessWeek* about the book: “We're proud of the significant strides made over the past several years to become an employer of choice, and committed to giving every employee the opportunity to achieve his or her full potential.”

Since these suits were filed, women have actually lost ground on Wall Street. They have suffered disproportionately in cutbacks, and overall, the number of women in financial services has dropped by 15% in the past two years, according to the Bureau of Labor Statistics. Since 1998, the number of female assistant managers and sales managers at Smith Barney has climbed 46%. In raw figures, however, that represents only 35 of a total 349 positions. Krawcheck will have to do better.

BY HEATHER TIMMONS
Timmons covers banking.



IN THE '90s, AN ANIMAL HOUSE CULTURE REIGNED AT SMITH BARNEY. HAVE THINGS CHANGED MUCH?

ONE

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BY STEPHEN H. WILDSTROM

tech&you@businessweek.com

THE LIBERATION OF LAPTOP DESIGN?



Tablet innovations may goose the long-stagnant look of standard notebooks

Since the notebook computer evolved into its present form about a decade ago, its design has remained fundamentally unchanged. Laptops have packed a lot more capability into smaller and lighter packages, but the basic layout—display in the lid, a keyboard with a pointing device in the base—hasn't changed.

Now, at a time when a tough market has made most hardware manufacturers more conservative, the coming of the Tablet PC is forcing a rethinking of the notebook. Whatever the shortcomings of the Microsoft Tablet PC software (Tech & You, Nov. 18), the liberation of laptop design could be a lasting contribution.

Although Microsoft set specific hardware requirements for the tablets, it gave manufacturers considerable design freedom. So, unlike the lookalike, work-alike Pocket PCs, there's a lot of variation among tablets. I took a look at four of the initial products, representing three different approaches: modified clamshell notebooks from Toshiba and Acer, a pure, no-keyboard tablet from Fujitsu, and a unique hybrid with a detachable keyboard from Hewlett-Packard.

The Toshiba Portégé 3500 (\$2,299) and Acer TravelMate C102Ti (\$2,199) have similar designs. Each looks like a standard ultralight notebook, but the screen pivots 180 degrees and folds flat over the keyboard to form a tablet. The Toshiba is the speediest of all the tablets, with a 1.3-GHz Pentium III-M, and it features a 12.1-inch display rather than the 10.4-in. screens found on other tablets. There's a price for those goodies: It's nearly a pound heavier than the others and runs just over three hours on a charge—about an hour less than the competition. The Acer goes with an 800 MHz ultra-low-voltage Pentium III-M. All of the tablets come with 20- or 30-gigabyte hard drives and 256 megabytes of memory.

Each also has a big problem when working as a tablet. The Acer comes with a tiny pen, about the size of a Palm stylus, that quickly becomes

uncomfortable. A larger pen is also supplied, but there's no way to store it in the notebook. And the Toshiba is much worse than the others at emulating the feel of a pen on paper when writing on the tablet. The screen is too slick, which makes it hard to write accurately and legibly. Another concern is the durability of the complex screen hinges. A standard laptop hinge has to move on only one axis, yet it is the largest source of mechanical failures. The tablet design multiplies the chances of trouble.

The Fujitsu Stylistic ST 4110 is probably the tablet most likely to succeed because it has a small but solid built-in market. Fujitsu has been selling tablets for years, using cobbled-together software to handle pen entry. They are used mainly in specialized markets, such as insurance, largely for filling out electronic forms. For these uses, the Tablet PC software is a vast improvement.

The Stylistic is a bit like an electronic clipboard. There's no mechanical keyboard, and data entry is done by writing with the special pen or tapping a virtual key-

QUICK-CHANGE ARTIST

The Compaq is the most interesting of the bunch

board on the screen. (A caveat: You don't want to lose the pen with any tablet—unlike touch screens, you can't substitute another stylus a regular pen, or a finger.)

In many ways, the HP Compaq Tablet PC TC1000 is the most interesting of the bunch. The basic unit, powered by a power-thrifty 1-GHz Transmeta Crusoe processor, resembles the Fujitsu. But it attaches to a clever keyboard that can serve as a base, somewhat like a standard notebook, and can fold behind the tablet, like the Toshiba and Acer. The Compaq slides into a docking stand with or without the keyboard attached. And with prices starting at \$1,699, the Compaq is the most aggressively priced tablet.

At this early stage, it's difficult to tell how the tablet PCs will evolve or what impact these novel products will have on laptop design. The fact that two of the three largest laptop makers, Dell Computer and IBM, aren't making tablets reveals deep industry skepticism. Still, I think that as the software gets better and the hardware—especially the relatively expensive radio-frequency pens and digitizers—get cheaper, pen entry and maybe even pivoting screens will become options on many standard laptops. The more radical HP Compaq might even inspire a jolt of design innovation in a notebook market increasingly dominated by all-but-indistinguishable PCs.

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BY GARY S. BECKER

AN ATTACK ON SADDAM WON'T SEND OIL SKY-HIGH



WIN-WIN:
After an initial jump, prices will fall sharply, assuming the Iraqi dictator is dispatched fast, as is likely

After the Republican victories in the recent election, President George W. Bush is sure to pursue his domestic and international agenda aggressively. High on his list of priorities will be a showdown with the Iraqi regime of Saddam Hussein. Many people have been concerned that a war in the Middle East would severely disrupt America's economy and that of other industrial countries by causing a sharp spike in prices and a shortage of oil. But this concern overstates the importance of Middle East producers to the world's economy, and it's mistaken about the effects of a war on oil prices. In fact, with a quick and decisive defeat of Saddam, the price of crude oil is likely to fall sharply.

One reason for this relatively sanguine outlook is the reduced importance of oil to the U.S. economy, compared with 25 years ago. America's spending on oil rose to about 8% of its gross domestic product after the first world oil shock in 1973. But today, oil accounts for only 3½% of GDP thanks to more efficient cars, houses, and equipment, and a shift of production in the American economy toward less energy-intensive methods. The drop in the importance of oil to Europe and Japan has been sharper still. So even a steep spike in oil prices would be much less disruptive to advanced economies than were the major oil price shocks of 1973 and 1979.

Moreover, though the contribution of oil imports to America's domestic consumption has risen from about a third in 1973 to over half during the past 30 years, much of it comes from Mexico, Venezuela, Canada, Norway, Britain, Russia, and a growing share from African producers. Persian Gulf nations provide only about 20% of imported oil, or a little more than 10% of domestic consumption. Imports from other nations would be unaffected by disruption of supplies from the Middle East, though prices would increase.

Predicting what would happen to oil prices should the U.S. and its allies attack Iraq is not an exact science, but the Persian Gulf War provides valuable evidence. Prices more than doubled after Iraq invaded Kuwait in August, 1990. Then they fell sharply from more than \$30 a barrel to about \$20 shortly after Desert Storm began in January, 1991, when it became clear that America's aerial bombardment would quickly defeat Iraq. Oil prices remained at that level for months following the initial attacks despite significant shortfalls in production from Iraq and Kuwait because Saudi Arabia and non-OPEC nations made up the deficit.

Something similar will happen this time. Worst oil prices probably will rise further as war with Iraq appears to be more certain. However, the first few days indicate that Saddam will be decisively and quickly defeated, as is highly probable, then oil prices will fall sharply as the "war premium" disappears and uncertainty about world oil production diminishes. Cutbacks in Middle East output would be much smaller than during the Persian Gulf War since Kuwait's facilities would not be destroyed, and Saddam has much less power to damage other facilities than a decade ago. Al Qaeda and other terrorist groups might try to destroy some pipelines and oil-production centers, but they will not do a lot of damage, partly because these facilities will be guarded closely during and immediately after any war.

After a defeat of Saddam, a friendlier and more democratic Iraqi government is likely to be installed. Oil prices would then fall further than they did after the Desert Storm cease-fire, since that government would be released from the oil embargo restrictions that were imposed on Iraq under the previous regime. A new government would also look for oil revenue to help rebuild an Iraqi economy that has deteriorated so greatly under Saddam. Since Iraq has the world's second-largest oil reserves, it has considerable potential for greatly increased production.

Some economists and politicians have called for reducing the U.S.'s dependence on imported oil by subsidizing domestic exploration and by greatly increasing the tax on gasoline consumption and other heavy uses of oil. I have argued in an earlier column that increased gasoline taxes are preferable to the minimum gas-mileage standards imposed since the 1980s on fleets of new cars. But an even more effective response to the threat of oil-supply disruption is to quickly build up the Strategic Oil Reserve far beyond its present level, which is equal to about eight weeks' supply of imports. A greatly enhanced reserve, perhaps a 16 weeks' supply, would make it much easier to survive protracted periods of chaos in the Middle East.

Saddam Hussein is a cruel dictator, and I believe he would be extremely dangerous to the world if left unchecked. Other issues are also relevant in determining whether to go to war against his reign. But fear of a sharp and prolonged rise in oil prices should not be one of them, for the most likely scenario is that oil prices will fall significantly and remain low after his regime is toppled.

Gary S. Becker, the 1992 Nobel laureate, teaches at the University of Chicago and is a Fellow of the Hoover Institution.

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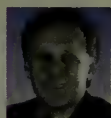
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BY JAMES C. COOPER & KATHLEEN MADIGAN

PRODUCTIVITY GAINS: THE GOOD NEWS AND THE GOOD NEWS

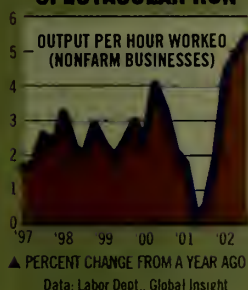
They'll boost profits next year—and not at the expense of salaries

U.S. ECONOMY

The surge in productivity has been one hallmark of this recovery. According to the Labor Dept.'s latest data, output per hour worked at nonfarm businesses grew at an annual rate of 4% in the third quarter. For the past year, productivity rose a remarkable 5.3% (chart). That advance is faster than any yearly rate posted in the New Economy boom years of the late 1990s. In fact, you have to go back to 1971 to beat it.

Strong productivity gains create a positive fundamental for any economy. Higher efficiency can lift both profits and workers' incomes, and it keeps inflation low and borrowing costs affordable. As Federal Reserve Vice-Chairman Roger W. Ferguson Jr. said on Nov. 12: "In the long run, strong growth of productivity is unambiguously positive."

PRODUCTIVITY'S SPECTACULAR RUN



But what about the short run of, say, the next few quarters? In this case, productivity gains will boost the economic sector that needs it most: Corporate America. Greater efficiency will enable companies to make more money. Additional cash will give businesses the wherewithal to start investing in new equipment again. And a better profits outlook will also sustain the stock market rally.

CLEARLY, COMPANIES WILL NEED help to make an extra buck, especially in the fourth quarter. The latest data indicate that economic growth is slowing this quarter, perhaps to as low as 1%, after real gross domestic product grew at a solid 3.1% annual rate in the third quarter.

Given such an unpromising outlook, profits seem to be facing a rough period. After all, companies can fatten their bottom lines three ways: They can boost revenues by either marking up prices or selling more goods and services, or they can cut costs. But in today's sluggish economic environment, the first two strategies aren't helping much. The slowdown in domestic spending and weaker global economies mean revenues won't rise much this quarter. And since modest demand growth leads to intense competition for customers, pricing power remains a no-show.

That leaves cost-cutting as the main profit-booster.

Companies are already announcing layoffs and holding down their capital budgets. They're also reluctant to spend money on rebuilding inventories. But bear in mind that those strategies cut a business' total costs, not necessarily the cost of making one item, and they usually give only a one-time lift to profits. Once the round of layoffs or capital-budget cuts is over, businesses have to cut payrolls or investments further to help the bottom line again.

But many companies are taking a smarter approach. In congressional testimony on Nov. 13, Fed Chairman Alan Greenspan noted that in the current business climate, "lowered costs are generally associated with increased output per hour." By boosting productivity, companies cut the cost of making one unit of product, be it a new computer, a stock trade, or a hamburger.

Lower unit labor costs have lessened the blow to companies' bottom lines from their lack of pricing power (chart). That's because falling unit costs increase the profit margin on each good or service sold. That will position companies to take full advantage of their more efficient operating leverage when demand growth turns around in 2003.

NO PRICING POWER, BUT UNIT COSTS ARE FALLING



Of course, some of the recent jump in productivity is purely cyclical. That is, output per work-hour generally picks up at the start of a recovery because companies burned by the recession are slow to hire more workers when demand first turns around. But so far in this upturn, productivity's contribution to output has been twice as large as its average share in past recoveries. That suggests a substantial portion of the gain is the result of structural changes.

Greater use of technology and more efficient business procedures shift the long-term trend of productivity higher. As Greenspan has pointed out, over time, workers become more proficient with existing equipment and work processes, so productivity can continue to grow even if companies don't buy any new equipment.

THE UPTREND IN PRODUCTIVITY is no panacea for the business sector's current problems. First, at a time when people are worried more about deflation than inflation, companies would benefit from stronger pricing

Business Outlook

power. Second, productivity gains will do little to curtail executives' uncertainty caused by corporate scandals and the expected U.S. invasion of Iraq.

This hesitancy of businesses to move forward can be seen in the Fed's latest senior loan officer survey of bank-lending practices: The report says 53% of U.S. banks reported weaker demand for commercial and industrial loans from large and midsize companies in October, vs. 45% in August. Loan demand from small outfits also weakened. On balance, banks are still tightening their lending standards.

Productivity's large contribution to output growth also presents a negative for the economy, since private payrolls have been essentially flat this year, aggravating the decline in consumer confidence.

BUT JOB JITTERS haven't constricted consumer spending yet. That's because, amid rapid productivity growth, gains in profits don't have to come at such a heavy cost to workers as had been true in the past. Note that, even with little job growth, real incomes are rising about 3% this year. That increase in buying power reflects the paradox of falling unit-labor costs and rising worker compensation (chart). In a highly efficient business world, workers can receive healthy pay raises even as the companies they work for cut the labor cost of each unit of output.

In the third quarter, for instance, workers at nonfarm

businesses saw their average hourly compensation rise by 3.3% from a year earlier, a 1.7% advance in buying power, after accounting for inflation. But because those workers produced 5.3% more output each hour than they did in 2001, businesses experienced a 2% reduction in their unit-labor costs.

The drop means that throughout the economy, third-quarter profit margins, which will be reported by the Commerce Dept. on Nov. 26, improved from a year ago. A larger profit margin means that, when demand picks up next year, the most productive businesses will earn more from each extra dollar of revenue, and that will translate into a sizable advance in total profits.

Can investors count on a return to 20%-plus earnings gains? Given the lack of pricing power, that may be too optimistic except for the hottest companies. But the latest numbers show that, even in an era of no significant revenue gains, companies are increasingly leveraging productivity to hold down costs and lift their profit margins. The overall benefits to the bottom line are already starting to show up, and the bounty will grow in the coming year.



SOUTH KOREA

A SLOWDOWN, BUT NOT A STALL-OUT

South Korea's slowdown in recent months is a bump in the road unlikely to trip up one of Asia's fastest-growing economies.

Despite some soft third-quarter data, growth of about 6% this year and 5% to 5.5% next year seems likely, about double the pace of 2001. The pickup reflects strength in both domestic demand and exports, fueled by last year's record-low interest rates and the won's depreciation last year.

Industrial production and sales by retailers and wholesalers are cooling off. However, that's partly the result of labor strife and bad weather. It also reflects the expiration of a tax exemption on certain big-ticket items that had boosted con-

sumer spending. New restrictions on loans and credit cards were also enacted to chill demand spurred by cheap credit.

The Bank of Korea is more worried about inflation than slow growth. Inflation, at 2.8% in October, is expected to rise next year. Korea can sustain about a 5.5% growth rate without pushing up inflation.

The bok is especially concerned that low rates are generating too much household debt and a bubble in property values. Housing prices have surged 20% this year. The bok last lifted its benchmark rate in May, from 4% to 4.25%, but has since held it steady. Most recently, it cited cooler property

prices in October and uncertainty in the global outlook. Political considerations may also be a factor, given the December presidential elections.

Although domestic demand is slowing, companies feel little pressure to cut costs, considering solid first-half profits. So labor markets remain healthy, which will limit the consumer-spending slowdown.

Strong exports are essential to Korea's growth goals. Despite a tepid recovery in the U.S., Korea's largest overseas market, exports are booming. That's partly because China, Korea's second-biggest market, is taking up some slack. October exports grew 26%, the fastest yearly rate in more than two years, helped by a 69% surge in shipments to China. This is a key reason why the economy should remain on track next year.





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HOW BUSH WILL STROKE THE ENGINE

Tax cuts are a near-certainty, with business set to score

George W. Bush seems to be drawing two big lessons from his party's thumping Nov. 5 election victory: Voters like his bash-Iraq policy, and they're willing to give the White House a little more time to fix the faltering economy.

With an Iraq invasion likely by early next year, the President has a small window to weigh measures aimed at jump-starting the sputtering expansion. And Corporate America hopes he seizes the moment. "Now is the time to step on the gas," says Pfizer Inc. CEO Henry A.

McKinnell. "It's time to start talking seriously about a stimulus package."

Revvng the nation's economic engine represents more than an opportunity for a newly empowered President—it's a political imperative. "Republicans now have the ability to do many of the things they wanted to do," says Mark Kvamme, a partner at Sequoia Capital, a Silicon Valley venture-capital firm. "They will have no excuses."

Trouble is, Bush's economists are still

The Options

President Bush vows to provide new stimulus. But before deciding how much to goose the economy, the White House will judge how weak conditions are over the next few months.

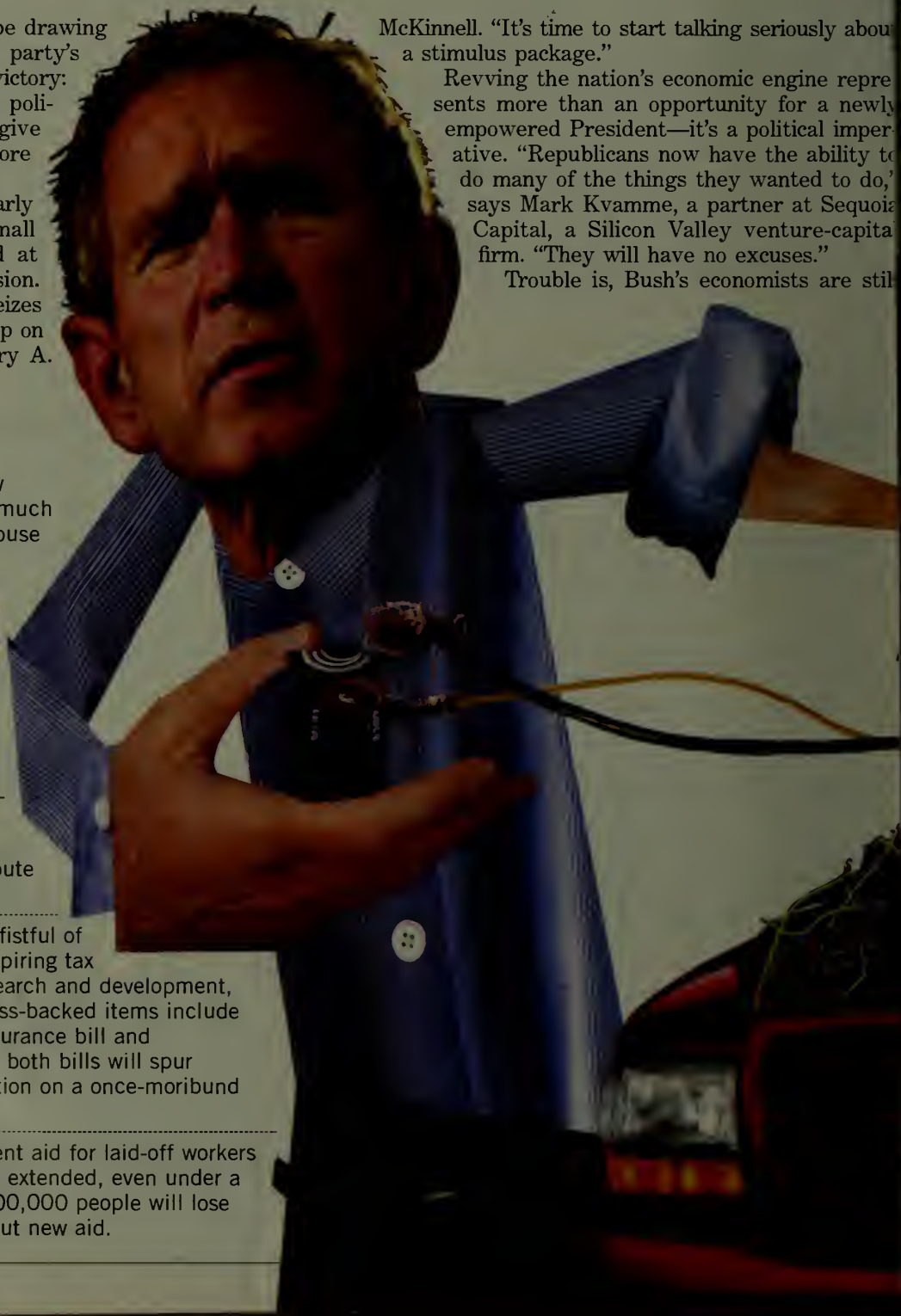
IF THE ECONOMY MENDS...

PERSONAL TAX CUTS Bush will focus on long-term issues. His top priority: Making the 2001 tax cut, due to expire in 2011, permanent.

PENSIONS The GOP will push modest reforms of pension rules and let workers contribute more to their 401(k)s and IRAs.

BUSINESS TAX BREAKS A fistful of expiring tax preferences, such as a credit for research and development, will be extended. Other likely business-backed items include a deal on a long-stalled terrorism-insurance bill and bankruptcy reform. Bush claims that both bills will spur growth over the long haul, as will action on a once-moribund national energy policy.

WORKER RELIEF Unemployment aid for laid-off workers will likely be extended, even under a Republican Congress. As many as 800,000 people will lose benefits by the end of the year without new aid.



debating the details of his 2003 agenda. Treasury Secretary Paul H. O'Neill, worried about the impact of a huge stimulus on the deficit, wants to limit the size of any package. Besides, he believes the nation's economic malaise is limited largely to a few sectors, such as tech and telecom. White House economic adviser Lawrence B. Lindsey, who frets that a sluggish stock market could drag the economy down, wants to aid hard-hit investors and consumers. Council of Economic Advisers Chairman R. Glenn Hubbard, meanwhile, thinks puny investment is the culprit and wants to target tax relief to business. Then there's Bush political guru Karl Rove, who fears the electoral consequences of a bad economy and favors strong measures ASAP. Sighs one top official: "There is no common agreement on what the problem is."

In the end, economic conditions in early 2003 will shape the package. If the economy appears to be slowly gaining momentum, Bush will be tempted to offer just a sprinkling of short-term incentives while pushing aggressive, longer-range tax cuts. But if things start unraveling, turning Federal Reserve Chairman Alan Greenspan's concerns about an economic "soft spot" into a swamp of malaise, the President will push a bigger stimulus plan. Its focus: quick tax relief for individuals and investment incentives for businesses.

No matter which path Bush takes, don't expect a stimulus package that balances tax reduction with the big-time spend-

ing favored by some. "You'll see relentless pressure for tax cuts," says Brookings Institution economist William Gale.

If the economy improves on its own, the Administration will cast stimulus as a bundle of initiatives aimed at improving long-term prospects for growth and job creation. The centerpiece: making Bush's 2001 tax cuts permanent. Under this sunnier scenario, the President would also propose making it easier to contribute more money to 401(k)s and Individual Retirement Accounts. To aid the jobless, Bush will agree with Democrats to extend unemployment benefits to out-of-work Americans. The result: lots of lofty talk about boosting the economy, but not much in the way of the emergency fiscal measures that econo-worrywarts favor.

But if growth slows sharply from the third quarter's 3.1%, as many economists predict, the White House will go on red alert. The odds then favor a stronger stimulus package, in the neighborhood of \$100 billion or more. Among possible relief measures: accelerated rate cuts for individuals, tax breaks for scorched investors, new incentives for corporations to buy equipment, and cash to states facing budget crises. A slow-to-heal economy, says GOP strategist Ed Gillespie, "is the greatest threat overhanging the Republicans and President Bush for the next two years."

While a weak economy poses long-term risks for Bush, it also presents short-term opportunities. It allows him to market the GOP tax agenda as economic stimulus. And it makes it more likely that Democrats will sign on. Already, key Democrats, including Senator Joseph I. Lieberman (Conn.) and Representative Richard A. Gephardt (Mo.)—both Presidential aspirants—are backing their own versions of tax stimulus. Instead of debating future cuts, "we need one now," says Democratic strategist James C. Carville.

One sign of the new political dynamic in Washington: There could be bipartisan backing for business tax breaks despite the bad aftertaste left by this summer's corporate crime wave. Under the rubric of stimulus, oil-and-gas producers are in line for billions in tax goodies to boost domestic production. But the Administration's focus will be to provide

IF THE ECONOMY TANKS...

MORE TAX CUTS If fears of a double-dip recession are rampant in January and Bush's political advisers begin to sweat, tax-rate cuts scheduled for '04 and '06 will be moved up.

INVESTMENT INCENTIVES If the market rebound proves illusory, the White House may dust off ideas to permit scorched investors more opportunity to write off capital losses.

BUSINESS INCENTIVES This could mean tax breaks for capital investment, lower corporate rates, and relief from the double taxation of dividends.

STATE BAILOUTS Congress, with a tacit nod from Bush, may try to transfer at least \$9 billion to flat-broke state governments. Since many new GOP governors face a fiscal crisis, the number could grow if the economy slows.

companies with more generous breaks for capital investment. Earlier this year, business got faster write-offs for equipment purchased before Sept. 11, 2004. Administration officials are now considering ways to sweeten those incentives. One possibility: making the depreciation rules permanent. Another: making them more generous for a limited time to encourage companies to speed up purchases.

The Administration also is considering two other approaches to help corporations. One would target investment incentives to such hard-hit industries as tech and telecom. Another would slash rates for all corporations.

Business leaders, naturally, say tax relief couldn't come soon enough. A new survey by the Business Roundtable reports that 64% of CEOs expect growth of 2% or less next year. "It may sound self-serving, but cutting the corporate tax

would help," says Herbert M. Baum, CEO of Dial Corp. in Scottsdale, Ariz. "It would allow us to keep more people."

Also topping the wish list of many execs: eliminating the double taxation of dividends. The President has "a great opportunity to pass a stimulus package," says Allstate Corp. CEO Edward M. Liddy. "Even something as simple as ending taxation of corporate dividends" would help. Bush isn't likely to do that because its \$75 billion annual price tag is prohibitive. But he may allow investors to get up to \$1,000 in dividends tax-free.

While corporations will receive some new tax benefits, the foundation of Stimulus III will be Bush's 2002 campaign promise to make his individual tax cuts permanent. Many of the measure's most popular provisions, including repeal of the estate tax and marriage-penalty relief, expire in 2011. Bush

COMMENTARY

By Peter Coy

WHAT IF YOU HAD TO FIX THE MESS?

Imagine that it's January, 2003. The economy has weakened. It's your job to craft the best fiscal policy to get things revved up again without breaking the budget. You don't need to take politics into account. (This really is an alternate universe.) What to do?

Tough choices lie ahead. You'll need to decide whether to emphasize reviving the economy right away or improving conditions for long-term growth. If you pick short-term stimulus, you'll have to choose whether to spend money on boosting consumer spending, business investment, or job growth. "Be clear on what it is we're endeavoring to do," Federal Reserve Chairman Alan Greenspan said last year.

There's a good case to be made for doing something in the short term—especially by getting more money into consumers' pockets. The economy is running far below its potential, and the Bush Administration proved last year with its tax rebates that the government can inject stimulus quickly enough to ameliorate a downturn. The long term is vital as well, of course—but the arguments are trickier there. While big, permanent tax cuts encourage work and investment, recent research shows those gains can be outweighed by the drawbacks of bigger budget deficits.

But that's jumping the gun. Let's start by looking at your options. In the short term, your best target is probably consumer spending. Consumers account for 69% of gross domestic product. If

people keep their wallets shut, businesses will cut back investment even more. That's why Goldman, Sachs & Co. economist Jan Hatzius advocates cuts in personal income taxes, which help keep consumers spending even as they increase saving to compensate for stock-market losses.

But who should get the cuts? Politics aside, the best way to boost consumer spending is to aid families in the lower half or so of the income distribution. That's because higher-income families save most of their tax cuts, which reduces their stimulative effect. You might want to temporarily cut rates for the bottom two income brackets. In addition, to help the 50 million filers who that don't pay income tax, you could send out rebate checks or cut the employee-paid portion of Social Security and Medicare payroll taxes. And it makes sense to extend unemployment benefits.

In contrast, the Bush Administration's concept of moving up the 2004 and 2006 tax cuts to 2003 isn't a cost-effective short-term stimulus, since the vast majority of tax cuts will go to high-income families that save them.

You might want to juice up business investment a little as well. Both faster depreciation and investment tax credits

make it easier for companies to buy equipment and software.

For a quick spurt, it probably makes sense to do some of each—temporary. A recent paper by economists from Federal Reserve and the American Enterprise Institute for Public Policy search concluded that temporary tax cuts for business investment this year



ally wants to lock in those cuts, and so does the public. In Nov. 8-10 Gallup Poll, the idea was favored, 64% to 29%.

The biggest battle will come over whether to accelerate the 2001 rate reductions that aren't scheduled to kick in until 2004 and 2006. Such a step would bring the top tax rate, which was 39.6% in 2001, down to 35%, cut the old 36% rate to 33%, trim the 31% bracket to 28%, and slash the 28% rate to 25%. Advancing the 2004 rate cut into 2003 would trim taxes by about \$17.1 billion, according to a new analysis by the Urban-Brookings Tax Policy Center. Moving up the 2006 rate cuts as well would pump a total of \$40 billion into the economy next year. Let 'er rip, says Joseph M. Grant, CEO of Texas Capital Bancshares Inc. Last year's tax cut, he says, was "too little, with too much delay."

Many demoralized Democrats will resist cutting rates. The problem, they argue, is that such reductions won't stimulate the economy since scant relief will go to the lower- and middle-class families who are the most likely to spend it.

Speeding up the 2004 tax cut, for instance, would put an average of less than \$35 in the pockets of families earning up to \$50,000, according to the Tax Policy Center. But families making \$1 million-plus would get an average tax cut of \$18,745.

Bush will not only have to sort out the elements of a cut, he'll also have to pick the size. A too-modest one would have little impact on a \$10 trillion economy. But with Wall Street economists predicting deficits of \$250 billion or more in '03 without stimulus, a supersize cut could throw the budget deep into the red and put upward pressure on interest rates.

Still, the U.S. also has an ailing economy. Dr. Bush's prescription will depend on just how sick the patient is. He has two choices: a big stimulus and a bigger stimulus. And the one he picks is likely to have a powerful effect on the economic future of the nation—and his own political future.

By Howard Gleckman and Richard S. Dunham, with Lorraine Woellert, in Washington, and bureau reports

There's no free lunch: Cutting taxes without cutting spending creates enormous budget deficits

"provided more immediate stimulus than a permanent tax cut would have."

Think, too, about new incentives for companies to hire or keep workers. Tax cuts won't help consumers if they lose their jobs—and unemployment is apt to keep rising in 2003 as companies cut costs. A quick way to help employees less costly is to cut the over-paid portion of Social Security Medicare payroll taxes. Senator I. Lieberman (D-Conn.) has proposed a "new jobs tax credit" to reduce payroll taxes for companies that increase employment soon.

Many economists argue that such quick fixes don't work. "Micro-managing stimulus is Washington being too clever by half," says Stephen J. Entin, president of the In-

stitute for Research on the Economics of Taxation.

That means you should think about long-term measures as well. What works? University of Michigan tax expert Joel Slemrod says permanent business tax cuts clearly raise business investment. Likewise, permanent cuts in capital gains taxes would encourage entrepreneurs to build companies, says Brian Wesbury, chief economist at Griffin, Kubik, Stephens & Thompson Inc., a Chicago investment bank. And highly paid people might work harder if they didn't have to pay almost 40¢ of their last dollar earned in federal taxes.

Unfortunately, there's no free lunch. Cutting taxes without cutting spending creates enormous budget deficits, which could crowd out productivity-enhancing business investment. For instance, making the Bush tax cuts permanent would cost \$4 trillion between 2011 to 2020, leaving aside the aid to growth

from lower taxes and the drag on growth from bigger deficits.

Tax cutters who say deficits don't matter point out that long-term interest rates have fallen even as the budget picture worsens. But markets are fickle. The fact remains that running chronic deficits "is putting off the day of reckoning," says Slemrod. "In the long run, the market will force you to either cut spending or raise taxes," says University of Chicago Graduate School of Business economist Austan Goolsbee. Harvard University economist Benjamin Friedman says Reagan-era deficits crowded out business investment, while Clinton surpluses helped trigger the capital spending boom of the late 1990s.

If the economy is weaker in January, you'll want to take firm action on the fiscal front. If you choose short-term measures, particularly to support the consumer, you'll give the economy a boost when it's needed. And because

your incentives will end soon, they won't add much to the debt. In contrast, permanent tax cuts would have less immediate impact, while adding to the debt that saps vigor from the economy. The choice seems clear. But, hey, it's your decision.

Coy is Economics Editor.

The Best Ways To Spark the Economy

—depending on which sector you think needs the most help

	POLICY	TRADE-OFF
REGULATE CONSUMER SPENDING	Cut income taxes, especially in lower brackets; grant tax rebates to workers who don't pay income taxes; reduce employee portion of payroll taxes; extend unemployment benefits	Widens budget deficit; could crowd out business investment; targets a sector that is relatively healthy and has already received stimulus
SPEED UP BUSINESS INVESTMENT	Speed up tax write-offs of purchased gear and give broad new tax credits for business investment	May reward investments that would have occurred anyway; could lead to increased layoffs as companies replace people with machines
CREATE NEW JOBS	Give tax credits to companies for hiring workers and cut payroll taxes paid by business for employees' Social Security and Medicare	Tax credits would trim government revenues; payroll tax cut would worsen Social Security and Medicare funding gaps

THE ECONOMY

CAPITAL SPENDING'S SPLIT PERSONALITY

Companies aren't building, but they're buying equipment

What's up with Corporate America? Propelled by a surge in consumer spending, the nation's economy grew at a rate of 3.1% in the third quarter. But for now, the long-awaited turn in capital spending still appears to be on hold. In its third-quarter report on gross domestic product, the government said that capital investment remained essentially flat, inching up just 0.6%. The question is more than academic: The Bush Administration—not to mention economists throughout the business community and on Wall Street—is increasingly worried that the recovery will lose steam without a sustained boost in business spending on new facilities and gear.

Turns out, though, that things aren't as gloomy as they appear. When it comes to technology, machine tools, and other long-lasting equipment, companies finally are starting to loosen the purse strings. Dig into the Commerce Dept.'s Oct. 31 report on the GDP and you'll see that third-quarter capital outlays on equipment and software—which account for roughly 80% of capital spending—increased 6.5% over the second quarter. That's double the 3.3% increase the second quarter turned in over the first. After an 18-month lull in which those sequential growth rates dropped quarter after quarter, companies finally have begun to spend a bit more on computers and other productivity-boosting tools.

So what, then, explains the flat overall growth in capital spending? The weakness can all be traced to the little-noticed but almost unprecedented free fall in spending on nonresidential construction. Private-sector investment in new factories, warehouses, offices, and other commercial buildings plunged 16% in the third quarter from the second. That's on top of a double-digit drop in the first half. All told, business investment in fixed assets has fallen by



nearly a third from its peak of \$220 billion two years ago, to an annualized rate of \$160 billion today.

Moreover, real estate execs and economists foresee no turnaround until next year at the earliest.

McGraw-Hill Construction, which like *BusinessWeek* is owned by The McGraw-Hill Companies, figures office construction, for example, will drop another 8% in 2003 after a 29% plunge this year. Adds Kenneth D. Simonson, chief economist for the Associated General Contractors of America: "It could be a long time before companies call in the architects and engineers for new space."

It's routine, of course, in a weak economy for construction to slump and vacancies to soar. Vacancy rates in the top 10 U.S. office markets have jumped to 16.1% from 8.5% two years ago, according to real estate tracker Torto Wheaton Research. What's new is the soaring vacancy rate for industrial properties, which has risen to an estimated 12%. That's double the rate immediately following the 1990-91 recession.

QUIET: Dot-com offices like Excite@Home's former headquarters are empty—jacking up vacancy rates

Cyclical factors explain part of that jump. The dot-com bust and telecom rout helped jack up vacancy rates: Developers went into a frenzy building for these tenants through 2000, only to have vacan-

ties now. "There's just no need for new plants," says Hamid R. Moghadam, chairman and CEO of industrial real estate firm AMB Property Corp. "We are not at the trough of the cycle yet."

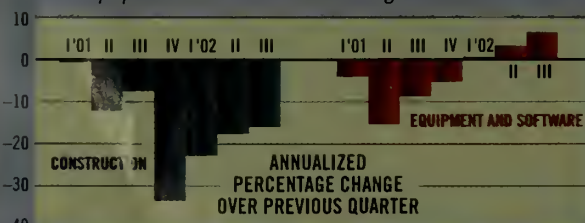
But long-term structural changes in the economy, as much as the cyclical slowdown, appear to be at work. As manufacturers rely increasingly on labor in low-wage nations such as Mexico and China, demand for U.S. factory space is weakening. In addition, businesses are intensifying their push toward just-in-time inventories, which means the U.S. needs fewer warehouses.

The construction collapse isn't necessarily bad news for the economy. Companies that are spending little on structures have been able to redirect more of their limited capital budgets to info tech and other new equipment that can quickly enhance productivity, notes Richard B. Berner, chief U.S. economist for Morgan Stanley. True, the quarter-to-quarter gains this year are a far cry from hikes of 18% to 20% in early 2000. But Berner and others believe capital spending will keep rising because, with high-tech prices falling, it's often cheaper to buy new stuff than repair the old. Instead of constructing new plants or trophy towers, companies are quietly reallocating scarce dollars to things that matter most.

By Michael Arndt in Chicago

FIRST SIGNS OF A REVIVAL?

Construction outlays are still plunging, but spending on equipment and software have begun to rebound



Data: Commerce Dept., Coldwell Banker Commercial



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COMMENTARY

By Emily Thornton

WHAT IT WILL TAKE TO POLICE THE STREET

So much for radical solutions to the conflicts that have tainted Wall Street research reports and the analysts who write them. Law enforcers and regulators may shelve the much criticized \$1 billion plan, pushed by New York State Attorney General Eliot Spitzer, to create an independent oversight board to force banks to distribute independent research. Instead, Spitzer and Securities & Exchange Commission enforcement head Stephen M. Cutler are considering having each bank employ an "outsider" to buy independent research to give to clients along with their own reports.

And forget about forcing all banks to hive off research into separate subsidiaries. Now, the goal is to beef up the Chinese walls between bankers and analysts. The new plan has brought the convoluted research saga one step closer to resolution. But some bankers say in private that its real impact will be "marginal" at best, and much work remains to be done.

Certainly, Spitzer and Cutler face a tough balancing act. If they want to convince the public that they have fixed Wall Street, they need to punish wrongdoers for past misconduct and roll out truly prophylactic remedies that root out the offending banks' conflicts of interest. Yet they have to ensure that measures enacted now don't clash with structural reforms for the industry, such as making initial public offerings fair and compliance effective, that SEC com-

missioner Harvey J. Goldschmid is working on.

As negotiations hurl forward, some law enforcers fear they'll run out of time to uncover all of Wall Street's abuses. That might undermine the momentum for reform. Top regulators, including the SEC's Cutler, want to settle quickly. But some state regulators prefer to finish their own investigations first. "I still have a lot of work to do," says one. In return for giving up their chance to find a smoking gun, they want some payback, such as imposing far stiffer penalties than the \$100 million Merrill Lynch & Co. paid to settle with Spitzer in May. That way, some of the 12 banks now being investigated could end up paying as much as \$250 million to settle.

Yet even if the banks agree to buy independent research and pay hefty fines, other big issues remain to be resolved.

Disagreements about how best to seal off analysts from bankers are still widespread. Most banks have conceded that analysts should not be al-

lowed to go on "road shows" or "pitches" for banking business. However, on Nov. 18, banks' legal counsels are expected to argue once again that analysts must assist bankers in pricing deals. Even if the enforcers were to agree, a skeptical public probably wouldn't—and that could undercut the settlement's credibility.

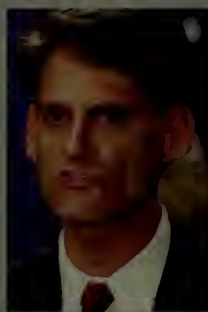
To restore public confidence in the markets, negotiators also must decide how analysts should be paid. Alas, no firm has figured out how to do that. Citigroup's plan to completely separate its research opera-

tions from banking might work as long as controls are strict and banking doesn't simply end up paying the bill, as before. Yet even if Citi's approach works, for now, no other firm has announced plans to follow it.

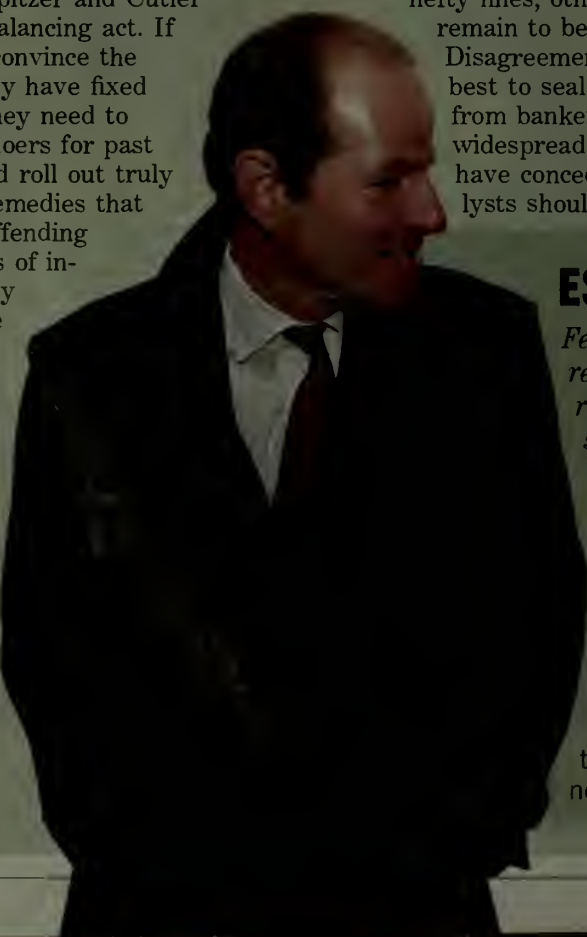
The real key to keeping Wall Street honest is compliance—enforcing rules designed to protect investors inside brokerage houses and banks. During the '90s bull

market, failure by the Street's top dogs to make compliance a priority fostered many of the practices that have brought them to shame. Banks agree that their heads of compliance should have a direct line to the CEO and that research should have its own legal department. But the SEC may have to insist that compliance officers blow the whistle if their bosses don't act. Without a realistic threat of exposure and punishment, reform efforts will remain marginal.

With Mike McNamee in Washington and Heather Timmons in New York



CUTLER: Wants a quick resolution



SPITZER: Trying a new tack

ESSENTIAL STEPS

Federal and state law enforcers are close to reaching a deal with banks to redress Wall Street's research conflicts. Here are some key reforms they should insist on:

HANDS OFF Bankers should be banned from consulting research analysts on deals or enlisting their help to promote them.

COMPENSATION Analysts' pay packages should be based solely on the value of their research to investors—not on how much banking business they generate.

COMPLIANCE Chinese walls should be high, thick, and heavily policed. Compliance officers need to report directly to top management.

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MIDDLE EAST

AN IRAQ ATTACK: WHAT ARE THE CHANCES NOW?

Triggers for war loom at every step in the inspection process



ROLLING IN: A convoy of U.S. Army vehicles makes its way to Camp Doha, a Kuwaiti military base. Many Bush Administration officials doubt Saddam will meet strict U.N. resolution standards

Iraqi strongman Saddam Hussein bowed to international pressure on Nov. 13 and agreed to allow weapons inspectors back into his country under the terms of a tough new U.N. Security Council resolution. That resolution, approved unanimously on Nov. 8, warns of "serious consequences" if Saddam fails to cooperate with the inspectors, who will be trying to find and destroy chemical, biological, and nuclear weapons, as well as missiles that could deliver them.

To Arab nations who supported the resolution and to other opponents of the threatened war, the inspections represent Saddam's last chance to avert an American-led attack. Here's a primer to help handicap the odds of a conflict as the U.S.-Iraq showdown plays out.

When will inspectors return to Iraq?

An advance team led by Hans Blix, executive chairman of the U.N. Monitoring, Verification & Inspection Commission, and Mohamed ElBaradei, director general of the International Atomic Energy Agency, will head to

Baghdad on Nov. 18 to discuss logistics. But a full complement of some 100 inspectors won't start work until Dec. 23. Before that, by Dec. 8, Saddam is required to fully disclose his weapons programs to the U.N.

Will Saddam admit he has weapons?

For him it's a dilemma. He has denied for years that Iraq has weapons of mass destruction. If he refuses to disclose weapons programs yet again, the U.S. could consider that very refusal a reason to go to war. The U.S. would then provide the Security Council with its evidence of Iraqi weapons, including an October Central Intelligence Agency report that found that Iraq continues work on banned chemical, biological, and nuclear programs.

Under the terms of the U.N. resolution, the U.S. is required to return to the Security Council for consultations—but not another vote—before taking any military action. If Saddam fails to cooperate,

the Bush Administration feels it can go ahead even without a new resolution authorizing force.

Maybe Saddam wants to cooperate, in order to avert war.

That's a possibility, although many analysts doubt he really wants to give up his weapons of mass destruction. Still, if inspectors are given unfettered access to suspect sites, it might signal a change of heart. If Iraq cooperates, Washington thinks inspections could disarm Saddam, who might in the end decide that presiding over a less-potent Iraq beats a hailstorm of smart bombs. Under the U.N. resolution, the inspectors have until Feb. 21 to report to the Security Council on Iraq's cooperation. But they must report immediately if they are denied access to sensitive sites or face a pattern of harassment. That could set the stage for a conflict.

Isn't there a danger that Saddam will drag this process out?

The nightmare scenario for the U.S. is that Saddam is able to hide his weapons so well that even uncurbed inspections turn up nothing. Biological and chemical

weapons are particularly hard to detect. Such an outcome could leave the White House without a pretext for military action. Or Saddam could hand over some weapons—but keep others hidden. The U.S. would run up against a barrage of criticism if it goes after Saddam while he is seen to be cooperating. There's a time factor involved in launching military action, too. Most experts say the U.S. should not delay much past February

to start the war to boost the odds that it will be over before May's hot weather makes it hard for soldiers in protective gear to fight.

How likely is war?

Many experts think President Bush's tough rhetoric has put his credibility at stake. The Pentagon has invested heavily in moving troops and equipment to the region. And many Administration officials doubt Saddam will ever meet the U.N. standards. When these three factors are added together, a conflict seems inevitable. Still, other Iraq experts with close ties to the Administration believe the U.N. inspections may be successful enough to cripple Iraq's arms program and make war unnecessary.

Continued on page 42.

WE PROMISE TO EXPLAIN THE WONDERS OF OUR SYSTEM-ON-CHIP RESEARCH AND HOW SCOTLAND IS SHAPING THE FUTURE OF ELECTRONIC DESIGN.

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popular outside of
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horses were
expensive and rare.
This is because
they are impractical
for riding.



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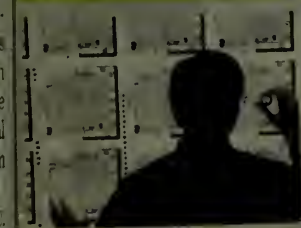
In electronic design, our innovative Alba Centre is leading the world's R&D in System Level Integration technology, as well as promoting enormously successful collaborations between top universities and private sector partners. And of course, there's Dolly, our now famous sheep who became the first mammal cloned from an adult cell—a direct result of Scotland's thriving and inventive biotech industry.

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SCOTTISH DEVELOPMENT INTERNATIONAL

If there is a conflict, how would the Pentagon wage the war?

What's expected is a short conflict that would start with an air assault designed to sever the communication network between Saddam and his troops. Allied ground forces would move in rapidly, especially in areas in the north and south where Baghdad has little control. These zones would provide staging grounds, reducing the need to rely on Arab neighbors for bases. To avoid urban combat, troops would surround Baghdad and hope Iraqi forces surrender en masse, as they did in Operation Desert Storm. The key unknown: whether the U.S. could knock out Iraq's

Bush's nightmare: Iraqi weapons so well hidden that inspectors find zilch

Scud missile sites before Saddam launches chemical or biological weapons.

How will the region react?

The Arabs don't want war but won't cry if Saddam goes. If there is a flagrant violation of the unanimous Secu-

rity Council resolution, that would provide cover for Saudi Arabia, Kuwait, Jordan, Qatar, and Turkey to line up with the U.S. and Britain. They might provide bases and overflight rights, and Turkey might provide troops.

In return for such help, Iraq's neighbors would want the U.S. to make sure regime change in Baghdad doesn't bring chaos to the region. That means not only averting a breakup of Iraq but also shoring it up, as well as thwarting any moves by Iran or Turkey to exploit the vacuum. Winning the peace could prove far harder than winning the war.

By Stan Crock in Washington, with Stanley Reed in Riyadh

DEREGULATION

A POWER COMPANY TRIES TO BREAK LOOSE

Can PG&E get out from under California's control?

Pacific Gas & Electric struggled to keep the lights on for millions of customers throughout most of California's energy crisis of 2000 and 2001. Now, as it seeks to emerge from Chapter 11, the beleaguered utility finds itself in a glaring spotlight.

On Nov. 18, a federal bankruptcy-court judge in San Francisco will open hearings to determine how California's largest utility, Pacific Gas, a subsidiary of PG&E Corp., should restructure to emerge from bankruptcy protection. The outcome has ramifications for California and beyond: If the company's plan is accepted, it would probably be easier for PG&E to jack up wholesale rates. That would be a blow not only for consumers but also California Governor Gray Davis, whose administration wants to continue state regulation to prevent prices from skyrocketing again. The case is being closely watched elsewhere for clues as to which direction the debate over power deregulation is headed.

At the center of the Pacific Gas bankruptcy case are two competing proposals: one from its parent company and the other from the California Public Utilities Commission, which regulates most of the company. PG&E wants to transfer

ownership of the plants and transmission lines from Pacific Gas, its utility subsidiary, to the parent. PG&E would later spin off Pacific Gas as a separate marketing company that would sell and transmit power to homes. The point of the maneuver? While Pacific Gas would remain under state oversight, the crucial production facilities would be regulated by the more market-friendly Federal Energy Regulatory Commission instead.

The plan riles state regulators and some consumer advocates, who fear that the feds would allow PG&E to raise wholesale rates. Ultimately, they argue, those hikes would be passed on to the utility's 4.6 million customers, who are paying as much as

30% more than they did two years ago.

Having suffered the consequences of one free-market-driven system blowing up in 2000, Davis and state regulators prefer to keep pre-deregulation controls. Those controls would allow the state to continue setting wholesale prices and ensuring that the utility has the generating capacity to meet demand. PG&E "wants to be able to sell power at whatever price the market will bear, just like other out-of-state generators that charge outrageous prices," says Gary Cohen, the commission's general counsel.

PG&E insists that it isn't looking to boost retail rates and merely seeks "stable" regulation. "There's a smooth hand and consistency about [the federal regulators] that gives capital markets more comfort," says Daniel D. Richard Jr., PG&E senior vice-president. Wall Street analysts find the company's proposal more palatable than the state's.

So far, PG&E is out in front. A federal judge on Aug. 31 ruled that the company can sidestep certain state laws that could hinder its plan. On Sept. 10, PG&E received a green light for its plan from 9 of 10 creditor groups. Michael Worms, an analyst at Gerard Klauer Mattison, says: "It's clearly looking better for the company." And a bit darker for foes of deregulation.

*By Louise Lee
in San Mateo*



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EXECUTIVE SUITE

PAGING DR. CAPELLAS

WorldCom needs help, fast.
Can the former Compaq
chief meet the challenge?

When Michael D. Capellas embarked on a turnaround at Compaq Computer four years ago, he quickly demonstrated his pragmatism and people skills. Having devised a massive restructuring plan, Capellas put his top 20 executives in a room and spent the next three days convincing them that the company had to change fundamentally. In the end, Capellas prevailed, reorganizing Compaq into half a dozen businesses, while dramatically improving its ability to compete with Dell Computer. Before long, Hewlett-Packard came knocking; the two companies merged earlier this year.

So can Capellas work similar magic at WorldCom Inc.? As *BusinessWeek* went to press, the 48-year-old exec known for his nuts-and-bolts operating skills was widely expected to join the bankrupt telecommunications giant as CEO. While some creditors had argued that the job was better filled with a telecom expert, after two days of back-to-back meetings it appeared that Capellas had won the skeptics over. Still, though he faces a tough task, those who know Capellas expect him to move quickly to impose financial and marketing discipline. "People find him refreshing," says Cristóbal I. Conde, CEO of SunGard Data Systems Inc., a Wayne (Pa.) provider of financial computer systems and a Compaq customer. "He's detail-oriented and delivers on his promises."

If named, Capellas won't have long to prove his mettle. The U.S.'s second-largest telco is struggling to emerge from bankruptcy protection, free itself of \$42 billion in debt, and restore a reputation tarnished by a \$9 billion accounting fraud scandal. It must do all of this within six months to prevent big customers



such as AOL Time Warner Inc. and FedEx Corp. from bolting to rivals.

Doing that while getting up to speed on the telecom sector won't be easy. Capellas will have to quickly master complex regulations, unfamiliar technology and new sales challenges—all while stabilizing the business. Among his first

challenges: getting WorldCom out of onerous bandwidth contracts, and finding buyers in a depressed market for noncore assets.

That's where the restructuring skills he honed at Compaq should come in handy. In 1999, his first year as Compaq CEO, he cut operating expenses by 17% and hiked gross margins by three points, to 23.6%. Most important,

CRACKERJACK: Capellas has solid credentials but lacks telecom experience

Compaq made a profit. In the second quarter of 2000, it earned \$387 million, vs. a \$184 million loss a year earlier.

Capellas is also strong where WorldCom is weakest: He has credibility. "His credentials would go far in restoring WorldCom's respectability," says Susan F. Shultz, founder of SSA Executive Search International Ltd. She believes he can attract a reputable slate of directors to replace the current board, which has been accused of being too cozy with ousted founder Bernard J. Ebbers.

Capellas may face a bigger hurdle in wooing customers. He'll be helped by his long-standing ties with the CIOs who will become WorldCom's biggest customers after the reorganization, since the tentative plan calls for WorldCom to be pared down to its data-service and Internet access units. Capellas began at Compaq as the CIO and has kept in touch with colleagues as a salesman and marketer. To win them over, though, he'll have to make WorldCom viable.

That's why his top priority will be guiding WorldCom out of bankruptcy. Already, creditors have tentatively agreed to forgive much of the debt and take equity for the rest, basically leaving WorldCom debt-free. The company hopes to file a final restructuring plan for court approval by Mar. 31. "We've got a working agreement with creditors about where we're going," says Gregory F. Rayburn, the chief restructuring officer. "It's crucial that we don't linger in bankruptcy."

What happens after that? Some observers believe WorldCom will be sold to a Bell. In the meantime, Capellas will have to provide bold leadership. That may prove to be his most daunting challenge. Those who have worked with him say Capellas is adept at operations but has less strength outlining strategic visions or setting directions for growth. Still, just getting WorldCom to a place where such skills are needed may be achievement enough.

By Charles Haddad in Atlanta, with Steve Hamm in New York and bureau reports

WORLDCom's TO-DO LIST

The new CEO's agenda is clear:

SELL ASSETS Nonessential units like the paging and wireless resale businesses must go.

END CONTRACTS WorldCom figures it could save \$500 million a year by dumping bandwidth capacity it doesn't need.

WRAP UP REORG Creditors must sign off on a plan by Mar. 31 for the company to emerge from bankruptcy by early summer. Any later than that, and nervous customers could bolt.

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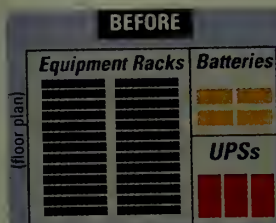
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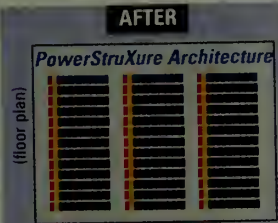
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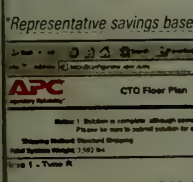
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HEALTH CARE

A SCANDAL-RIDDEN TENET STANDS BY ITS MAN

But without investors' trust, can Barbakow heal the company?

When Tenet Healthcare Chief Executive Jeffrey C. Barbakow offered to resign in early November, the board members gave the idea serious thought. After all, they were caught off-guard by the publication of an analyst's report accusing the hospital chain of garnering huge profits from aggressive Medicare billing. Barbakow had assured the board that most of the company's strong growth could be explained by aging baby boomers seeking treatment in Tenet hospitals. "It implied ethical lapses," says director and former U.S. Senator Bob Kerrey, now president of New School University in New York.

Yet in the end, the board stuck by Barbakow, in part because of his success in bringing Tenet Healthcare Corp. back from an earlier billing scandal in 1993. Back then, Barbakow was the guy brought in to clean house.

This time around, distancing himself from the scandal won't be so easy. True, he quickly removed his two top lieutenants, the chief financial officer and the chief operating officer of the company. But some investors and corporate governance experts believe Tenet's problems are at least partially the result of the aggressive profit-driven culture fostered by Barbakow himself. They question whether the former Merrill Lynch & Co. investment banker is the best person to tidy up Tenet today. "The only way investors will feel comfortable is with a new management team," says Thomas Marsico, chairman and CEO of Marsico Capital Management, which recently sold off its Tenet holdings. "He can't regain his credibility."

Among Tenet's raft of problems: It billed some \$763 million in Medicare



CEO JEFFREY BARBAKOW

"outlier" payments last year, employing a loophole that boosted total profits 20%. Outlier payments were 17% of Tenet's total Medicare payments, far greater than the national average of about 5%. The billing system is meant to be used to reimburse hospitals for excessive charges incurred during complex procedures, such as a heart bypass surgery that leads to complications. The system is intended to protect hospitals from having to shoulder too much of the cost for treating very sick, elderly patients. But outlier payments can also be easily abused, since hospitals determine the charges used to calculate payments. Tenet's Redding Medical Center in Redding, Calif., for example, charged 40% more for outlier payments than the seven other major hospitals within 200 miles.

FAT REWARDS

Barbakow sold \$130 million in Tenet stock when it was at 44. Now it's at 15



TENET

also sold \$130 million worth of Tenet shares when it traded at 44 in January. It now trades around 15.

Barbakow says he will work with Tenet's board to conduct a top-to-bottom review of pricing, compensation, and ethics. He says the company will announce a new, less aggressive strategy by the end of the year. But investors are going to need a lot of convincing that the man who long ago fixed Tenet is the one to do it again.

By Arlene Weintraub in Los Angeles

Barbakow faces other complications. On Oct. 30, the FBI raided the Redding facility as part of an investigation into allegations that two heart surgeons there performed unnecessary surgeries. No charges have been filed against the doctors or Tenet. The doctors are not Tenet employees and Barbakow says they were not pressured to generate high Medicare reimbursements.

How responsible is Barbakow for the mess at Tenet? He backed an incentive plan under which hospital CEOs receive cash bonuses tied largely to exceeding profit and revenue growth targets. In fact, cash bonuses represented half of all the compensation hospital chiefs earned in 2001. That incentive plan, critics charge, may have led to abuses.

Barbakow concedes that aggressive pricing at some Tenet hospitals led the company to collect excessive Medicare payments. But he insists that he was not aware of Medicare's impact on Tenet's earnings until confronted by a research analyst who had dug out the facts from publicly available government data. That alone, say some governance experts, is enough to push Barbakow out the door. "If you have a CEO who claims he doesn't understand where his revenues and profits are coming from, you need to change your CEO fast," says Lynn E. Turner, director of the Center for Quality Financial Reporting at Colorado State University. Says Barbakow:

"My judgment is only as good as the information I receive."

That's not the only thing damaging Barbakow's credibility. Investors are also upset over his benefitting from the Medicare controversy. His \$4.2 million bonus last year was mostly a reward for boosting earnings by 113%, to \$643 million on \$12 billion in sales. He

DAMAGING REVELATIONS

OCT. 30 FBI agents raid a Tenet hospital as part of an investigation into alleged unnecessary heart surgeries

NOV. 6 The Feds audit Tenet amid allegations that it overcharged the government for expensive treatments

NOV. 8 After Tenet shares fall 70% in the wake of the Medicare billing controversy, the COO and CFO depart



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In Business This Week

EDITED BY MONICA ROMAN

CONTENT IS KING AT AOL

WITH THE DECISION BY AOL Time Warner to give America Online veteran Ted Leonsis a greater role at the online-services unit, the push is on to develop more compelling content and focus less on advertising. AOL Vice-Chairman Leonsis, one of the last of the AOL Old Guard, assumes the responsibilities of AOL Interactive Services President James de Castro. The former hotshot radio exec with a strong advertising sales background resigned on Nov. 12, seven months after being recruited by AOL Time Warner co-CEO Robert Pittman, who resigned in July.

VIVENDI'S NEW 'CO-PRODUCER'

HOLLYWOOD MOGUL BARRY Diller, chairman of online retailer USA Interactive, has been given the interim title

of co-CEO at Vivendi Universal. Diller owns a 1.5% stake in Vivendi's U.S. entertainment unit, and USAI owns 5.4%. The onetime Fox and Paramount studio head is helping to design a strategy for Vivendi's entertainment assets, which include the Universal studio and theme parks. A Universal spokeswoman says Diller has been effectively operating as co-CEO along with Jean-René Fourtou, who became Vivendi's CEO in July when the board ousted Chairman Jean-Marie Messier. The USAI chairman does not draw a salary from Vivendi and has no contract.

YES, PENNEY, THERE IS A SANTA CLAUS

J.C. PENNEY GAVE INVESTORS an early Christmas present on Nov. 12 when it announced better-than-expected third-quarter earnings and reaffirmed its holiday forecasts. Aggressive marketing, better merchandise, and improved presentation helped Penney more than double profits for the latest quarter, excluding one-time items. Net income climbed to \$123 million—including the sale of the direct-marketing business—from \$31 million in the year-ago period. Two years into his turnaround, CEO Allen Questrom said that the department stores, catalog, and Eckerd drugstore businesses "are all progressing well."

CAN NASSER DEVELOP POLAROID?

FIRST, JACQUES NASSER TRIED to remake Ford Motor. But that didn't work. Chairman William Ford Jr. showed Nasser the door late last year, and Ford finished 2001 with a loss of \$5.5 billion. Now Nasser will try to remake another corporate icon: Polaroid. One Equity Part-

HEADLINER: SANFORD WEILL

THE TROUBLE WITH SANDY

Sanford Weill can't seem to stay out of hot water. The Citigroup CEO admitted in a Nov. 13 memo that he asked telecom analyst Jack Grubman to "take a fresh look" at AT&T. Grubman raised his rating on the stock in early 2000, and Citi won an investment-banking deal soon after. That October, Grubman lowered his rating. The events are being investigated by New York Attorney General Eliot Spitzer.

Weill's admission came after *The Wall Street Journal* reported that Grubman bragged in an e-mail that he was raising his AT&T rat-

ing to help Weill gain board support for co-CEO John Reed's ouster. Weill called the e-mails "defamatory."

He said he never told any analyst what they "had to write" and said his request came because of AT&T's "dramatic transformation." Grubman said in a statement that his e-mails were lies.

Weill's request to Grubman wasn't illegal, experts say. But it may end up being costly for Citi as regulators weigh how to punish Wall Street for conflicts of interest between research and investment banking.

Heather Timmons



CLOSING BELL

SMOKE BOMB

Philip Morris shares fell 14% on Nov. 12, to \$37.03, after the company said it couldn't stand by an earlier forecast of 8%-to-10% profit growth for 2003. As Marlboros hit \$7.50 a pack in some areas, cheaper rivals are gaining. A string of tobacco litigation losses on the West Coast has added to investor concerns.



ners, Bank One's leveraged buyout arm, has charged Nasser with refocusing the instant-camera company. One Equity paid \$255 million for 65% of Polaroid, allowing it to emerge from bankruptcy in July. Topping Nasser's to-do list: finding a CEO to help Polaroid compete in the Digital Age. The post has been empty since former CEO Gary DiCamillo left on July 1. Nasser's first step as non-executive chairman was to reach out to employees. "Like Polaroid, my company also confronted a major crisis," he wrote in an e-mail. They can only hope the results are better this time around.

ENERGY REGULATORS IN THE WOODSHED

THE FEDERAL ENERGY REGULATORY Commission missed warning signs about Enron and isn't devoting enough resources to overseeing the en-

ergy markets, according to Senate investigators. "FERC must reorient itself to a changed and increasingly complex competitive industry," says a report by the Senate Governmental Affairs Committee. The committee, led by Senator Joseph Lieberman (D-Conn.), said that FERC needs to improve internal communication and its coordination with other agencies. FERC Chairman Pat Wood says the agency is overhauling its approach to "assure a competitive marketplace that protects consumers."

ET CETERA...

- The FCC approved the Comcast-AT&T Broadband merger.
- Cartoonist Stan Lee filed suit claiming he has not received royalties from the film *Spider-Man*.
- Playtex hired J.P. Morgan to advise it on strategic alternatives, including a sale.

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EDITED BY MIKE McNAMEE

THE SEC: NO BOSS. NO ACCOUNTING COP. WHERE DOES IT GO FROM HERE?

The timing couldn't be worse. At one of the most critical points in its 68-year history, the Securities & Exchange Commission is rudderless. Although Chairman Harvey L. Pitt has not yet officially exited, his Nov. 5 resignation has eased political attacks and lifted morale. But it has also left a leadership vacuum just as the SEC is getting down to writing 27 major new rules and reports mandated by the Sarbanes-Oxley corporate-reform law. The Nov. 12 resignation of William H. Webster, the head of a new accounting oversight board that reports to the SEC, only makes the situation worse. How bad is it? Correspondent Amy Borrus takes a look.

Has the SEC ground to a halt?

Surprisingly, no. Despite turmoil at the top and chronic underfunding, the staff has maintained a frantic pace of rule-writing and investigations—and is not likely to slow down now. Most of the rules the agency must write, such as curbs on off-balance-sheet transactions, don't create partisan divides.

The SEC's division directors—most of whom are career staffers—traditionally operate with lots of autonomy. That's true especially at the Enforcement Div., which is conducting a record number of investigations into corporate fraud. Pitt's resignation "will not affect us at all," says Enforcement Director Stephen M. Cutler, who is working with state regulators to craft a plan to curb Wall Street analysts' conflicts of interest (page 38).

O.K., but without a chairman, won't the accounting watchdog be kept on a short leash?

Yes. The SEC commissioners can appoint a replacement for Webster. But because the board and the commission are supposed to work closely, they're likely to wait until a new SEC chairman is in place. After the Webster debacle, the White House will want a louder voice, too. And there's no obvious

candidate. The initial front-runner, John H. Biggs, until recently CEO of pension-fund giant TIAA-CREF, is probably too tarred by partisan fighting to get the nod. Lacking a chairman will make it tough for the new board to hire top staff and make more than routine decisions. And as long as Pitt is around, the board will steer clear of sensitive issues, such as whether to rewrite the guidelines for company audits.

So when is Pitt leaving?

President George W. Bush would love to close the book on Pitt's turbulent tenure. If he named one of the two other GOP commissioners—Paul S. Atkins or Cynthia A. Glassman—as acting chair, Pitt would decamp. But that would leave a four-member commission evenly split along party lines—and most likely dominated by pro-reform Democrat Harvey J. Goldschmid. But if Bush keeps Pitt around until the Senate confirms a successor, he faces criticism anytime Pitt's side wins a close vote. A likely flash point: new rules governing consulting work by accountants. Pitt, who opposed curbs on the ability of accounting firms to consult for audit clients, will probably favor rules that permit exceptions. The two Democrats will seek tight curbs.

When Pitt finally goes, who'll take over?

Ideally, the White House wants a squeaky-clean former SEC hand who can recharge the agency. And a law enforcement background would reassure investors. That puts Assistant Attorney General Michael Chertoff, former federal judge Stanley Sporkin, and James R. Doty, SEC general counsel during Bush I, in the running. Also being mentioned: former NASD Chairman Frank G. Zarb (page 8). Another option is an academic with no embarrassing baggage, such as Stanford professor Joseph A. Grundfest, a former SEC commissioner. ■



WEBSTER: Hello, I must be going

CAPITAL WRAPUP

GO CANADA

► Two ex-critics of Canada's trade policy have teamed up to defend Ottawa against charges by the Bush Administration that it is dumping subsidized lumber into the U.S. market. When he was the Reagan Administration's trade ambassador, William E. Brock criticized Canada for its export subsidies and import quotas. As President Clinton's ambassador to Canada, James J. Blanchard also took Ottawa to task for its trade barriers. Now, they co-chair

the U.S.-Canada Partnership for Growth to fight a 27% penalty tariff on Canadian softwood. The group will register with the Justice Dept. as a foreign agent since it is being funded in part by Canadian lumber interests.

LOST IN SPACE?

► With tax cuts and rising military spending a certainty in 2003, lawmakers looking to trim the budget are gazing longingly at NASA's \$15 billion allocation. Many are becoming convinced that the space agency is not offering

enough value for its taxpayer dollars, especially with huge cost overruns on the space station.

NOW THAT'S HUNGRY

► How hungry are pols for campaign money in the new no-soft-money era? Just before the election, one business lobbyist received an invitation to a fund-raiser from Republican Senator Peter Fitzgerald of Illinois, where Democrats swept the Senate and governor's races on Nov. 5. Not surprising—except that the invite was for 2004.



INDIA

CALLING BANGALORE

Multinationals are making it a hub for high-tech research

These may be dreary times in Silicon Valley. But in Bangalore, India, the technology boom is alive and well. Inside Intel's new \$25 million glass-and-chrome complex on Airport Road, 950 young engineers work around the clock designing new chips. Downtown, Sun Microsystems has added 400 engineers in its gray-marble development center for servers. Texas Instruments, Cadence, Analog Devices, and Cisco are rapidly expanding design centers for telecom products.

The construction boom in research and development labs under way all over Bangalore represents a new wave of investment that is pushing India sharply higher in the global technology food chain. In the first wave, starting in the 1980s, multinationals like General Electric Co. and Citibank took advantage of India's

huge pool of low-cost, well-trained, English-speaking technicians to set up mundane software-code-writing operations. Software services has since grown into an \$8 billion annual export industry, and is expected to reach \$50 billion by 2008. Then, in the '90s, Bangalore drew a spate of back-office service centers for handling everything from billing queries from U.S. PC buyers to credit-card applications.

Now, U.S. companies are turning Bangalore into a strategic base for genuine R&D, not just grunt work. The Indian staff of TI already has designed sophisticated chips for global markets and boasts some 200 patents. Intel Corp. says it will have 3,000 R&D staff in Bangalore by 2005; Cadence says it will double its engineering team in four years. In the software sector, on a Nov. 13 visit to Bangalore, Microsoft Corp. Chairman Bill

Gates unveiled plans to invest \$400 million in new research partnerships in India. In software, Germany's SAP has developed new applications for notebook PCs at its 500-engineer Bangalore facility, and is plowing in an additional \$100 million to boost space and staff. Oracle Corp.'s 2,400-strong center has generated such hot products as Oracle Student System, which helps colleges process admissions, housing, and graduation records. Cisco Systems Inc. and Intel are expanding labs to develop telecom-networking equipment.

As a research hub, Bangalore is approaching the scale of many U.S. centers. Since the beginning of 2001, 230 multinationals have piled into the city's industrial parks. Already, some 25,000 engineers work in Bangalore labs. In three years, predicts Nasscom, the Indi-

INTEL INDIA'S KANTIPUDI:
*The company is sending
 lots of R&D work his way*

an software association, that number should swell to 65,000, thanks to an additional \$1.5 billion in investment. When Intel CEO Craig Barrett visited Bangalore in August, he noted that a "whole ecosystem for IT is being built in India."

Bangalore still has shortcomings to address before it can rank as a first-class tech hub. The biggest is infrastructure: Like much of India, it's short of electricity. So most big complexes require their own power generators, hiking costs by 10%. The city lacks an international airport and good highways, hurting its value as an electronics manufacturing base. There also are India's inconsistent policies toward foreign investment and its tense relations with neighboring Pakistan.

But Bangalore's strengths offset many of these weaknesses. The biggest is India's huge supply of high-quality, low-cost engineers. Each year, India graduates 220,000 software and computer science engineers. Bangalore alone produces 25,000—almost as many as the entire U.S. The average wage is \$12,000, with a PhD commanding up to \$30,000 a year. That's about one-fifth the price in the U.S. Cisco, SAP, and other companies that have shifted research work to India report savings of up to 60%.

What's more, Bangalore is awash with veterans with global experience. For decades, U.S. chipmakers have relied heavily on Indian-born engineers to develop breakthrough devices in Silicon Valley. Now, Indian engineers are returning home to manage R&D teams in Bangalore. Many other engineers cut their teeth at local IT giants like Infosys Technologies Ltd. and Wipro Ltd., known for delivering high-end software and consulting tasks for multinationals.

These are among the reasons Intel is pushing more work to Bangalore, the site of its biggest design facility outside Portland, Ore. Intel's three-year-old campus has produced 62 patents for semiconductors, telecom switching equipment, and routers. In September, Intel set up a 40-engineer lab to work on its next generation of microprocessors. After manu-

facturing shifted overseas in previous decades, the focus of globalization is now research and design, says Intel India R&D director Manni Kantipudi, "and here India excels."

Texas Instruments has been mining Bangalore's brainpower since 1985, when it set up a small software service center. It now employs 850 on a 3-hectare facility that accounts for 30% of TI's global R&D work. Among other devices, Bangalore was responsible for Ankoor, a digital signal processor used in disk drives that has generated \$400 million in revenue since 1997. Other designers are working on multimedia devices for Eastman Kodak Co. and JVC. They also are playing a big role in TI's drive to produce a chip for cell phones that combines all functions on a single device.

Bangalore also is reaching new levels in software. For decades, multinationals' operations in India focused on tedious work such as writing code or troubleshooting. Now, Bangalore is originating software products sold globally. SAP developed a fast-selling program enabling clients such as Nestlé and Philip Morris to use its complex

business software systems on notebook PCs. Now the company, which next year will move into a new 6-hectare development center, is assigning its Bangalore team to the job of compressing its software to fit on hand-held computers and even cell phones.

Even so, Bangalore has its work cut out for it to overcome infrastructure bottlenecks. That's one reason why, despite abundant cheap labor, it still plays a marginal role in manufacturing—especially compared with China and Southeast Asia. Municipal and Karnataka state officials are upgrading highways around the city, and plan to open an international airport by 2005—making it easier for executives to get in and out and to ship electronics to foreign markets. Karnataka officials vow to upgrade electrical power and to open the sector to private investors. Officials also hope to win permission from New Delhi to open industrial parks where multinationals can manufacture without paying tariffs on imported materials and equipment.

"We cannot afford to fail," says Vivek Kulkarni, Bangalore's IT secretary.

For now, though, there is plenty of growth ahead even if the city sticks to information industries, which mainly need reliable telecom connections. Indeed, Bangalore's economy is growing at a torrid 10% annual clip—twice the national average. By 2010, Kulkarni predicts, its gross domestic product will reach \$15 billion, enabling it to pass Bombay as India's wealthiest city. Indian-American Hans Taparia, 29, a Massachusetts Institute of Technology graduate who runs a tech consulting business in Bangalore, says he sees old classmates arrive monthly. "Every day, it feels more like Silicon Valley to me," he says. Before long, that may be no exaggeration.

By Manjeet Kripalani in Bangalore

SAP CONSTRUCTION:
*Low-cost, high-quality
 engineers are a draw*



What Tech Recession?

COMPANY	INVESTMENT US\$ (MILLIONS)	R&D WORK	ENGINEERS
CADENCE	\$120	Chip design	150
CISCO	200	Networking solutions	600
HEWLETT-PACKARD	NA	Network management, software, e-commerce	1,400
ORACLE	NA	Software development	2,400
SAP	70	Software development	500
SUN MICROSYSTEMS	100	Network software	500
TEXAS INSTRUMENTS	25	Chip design	950

NA= Not available

Data: BusinessWeek

COMMENTARY

By Jack Ewing

A KEY MISSION FOR GERMANY: BEEF UP THE MILITARY

The troops of the 154th Tank Battalion in Westerbург, Germany, are already preparing for duty in Bosnia next summer. But they won't be bringing their behemoth Leopard II tanks, which were designed to take on the Soviets. Instead, the troops are learning how to operate a roadblock or patrol on foot. "It's a big effort," says battalion commander Lieutenant Colonel Klaus Reinecke.

The German military, designed to defend the homeland, suddenly finds itself scattered around the world in a way no one imagined a decade ago. German soldiers are fighting terrorists in Afghanistan, while German frigates patrol the Indian Ocean to prevent Al Qaeda operatives from fleeing the region. "The Bundeswehr today is a weapon of peace," boasts Defense Minister Peter Struck.

With defense outlays kept low because of a weak economy, Germany is losing clout in geopolitical debates

Yet this historic projection of military power, which puts a postwar record of 10,000 troops abroad, has exposed just how weak the German army has become. After years of inadequate spending, such missions have stretched military resources to the limit. The Luftwaffe doesn't have the capability to refuel its planes in flight. It even had to rent aircraft from Ukraine to get equipment to Afghanistan.

Embarrassing—and the situation is set to get worse. While France and Britain beef up their defense



KEEPING THE PEACE IN KABUL: 10,000 troops are serving abroad

budgets, financially strapped Germany is barely holding steady. This month, for example, the government waffled on a commitment to buy 73 of Airbus Industrie's new A400 military transports for \$9.7 billion. With defense spending of about 1.5% of gross domestic product, or \$25 billion, Germany is technically in violation of NATO treaties requiring members to spend at least 2%. On Oct.

30, U.S. Ambassador to NATO R. Nicholas Burns singled out the Germans for criticism in a Berlin speech. German defense spending is sure to be on the agenda when NATO allies meet at a Prague summit on Nov. 21.

At bottom, this is Chancellor Gerhard

Schröder's punishment for failing to fix the economy during his first term. And because Germany has already maxed out its foreign capability, it's not getting much respect in Washington. In the debate on Iraq, France and Britain have taken the leading European roles. German leaders such as Foreign Minister Joschka Fischer have instead spent their time begging the Bush Administration to forgive Schröder for his anti-American rhetoric during the recent election campaign. If Germany had more to contribute to global security, it might

get more respect in Washington. But the Bush Administration can easily afford to ignore Schröder.

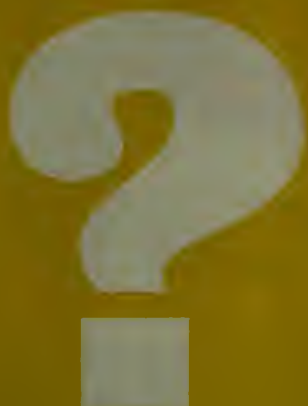
The prospects for a stronger Bundeswehr anytime soon aren't good. On paper, a comprehensive plan exists to slim down the army while increasing soldiers' pay and beefing up armored ground transport and air defense. But Schröder's governing coalition with the Green Party is having trouble agreeing on such funda-

mentals as whether to end the draft. And with a slack economy and a rising budget deficit, Germany would have to slash social spending to afford the up-front costs of a leaner army. "In Germany, that's politically impossible," Struck says.

Another factor is at play. Nearly 60 years after the defeat at Stalingrad killed 110,000 Germans, the country's citizens remain profoundly mistrustful of militarism. In principle, that's a good thing. In practice, Germany is in danger of shirking its responsibility. Even the nominally pacifist Green Party is alarmed. "Everyone agrees the Bundeswehr should be fundamentally reformed and modernized," says Winfried Nachtwei, a member of Parliament who is the Greens' point man on defense matters.

With the third-largest economy in the world, Germany needs to do more. Schröder will probably need to brave the outcry and close some bases to redirect funds to other parts of the military. The Germans could also cut the number of draftees but lengthen their service beyond nine months, barely enough for rudimentary training. Difficult choices, to be sure. But after four years of procrastination, difficult choices are all Schröder has left.

Frankfurt bureau chief Ewing covers German politics.



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MEXICO

IN THIS WAR, FOX IS ACTUALLY WINNING SOME BATTLES

His anti-narcotics drive is drawing applause from Washington

It was the first time in Mexico that television cameras were allowed inside a military courtroom, and viewers got an eyeful. Newscasts aired clips of the trial of two army generals accused of using military aircraft to help drug traffickers move cocaine and marijuana through Mexico to the U.S. On Nov. 1, General Francisco Quirós and Brigadier General Arturo Acosta were stripped of their rank and handed 15- and 16-year prison sentences, respectively.

The televised trial was part of President Vicente Fox's campaign against widespread collusion by officials in the multibillion-dollar drug trade. "It's sending a message to society and to the officer corps that this won't be tolerated," says Roderic Ai Camp, an expert on the Mexican military at Claremont McKenna College in California.

In the two years since Fox took office, his anti-narcotics effort has snagged 40 drug lords. The biggest fish: Benjamin Arellano Félix, the brains behind the ruthless Tijuana cartel, which handled an estimated one-third of the cocaine entering the U.S. Then in October, a yearlong undercover operation dismantled a ring of 22 corrupt officials from the attorney general's office and other agencies who had been funneling classified information to drug cartels. "This is a war we have to fight on all fronts," Fox declared on Nov. 3, describing a new drug policy that will focus on curbing drug use at home as well as quashing trafficking.

The antidrug push is one of the few big successes in Fox's otherwise beleaguered presidency. That's largely because Fox enjoys complete control of the federal agencies involved in the drug fight and doesn't need permission from the opposition-dominated Congress to go after drug kingpins. As the first opposition President after 71 years of one-

party rule, Fox is not beholden to the political bosses who may have links to the *narcos*.

Another factor: The President has no qualms about ruffling nationalist feathers by cooperating with Washington, which has enthusiastically praised Fox for his resolve. Mexico's previous Pres-

idents made a show of nabbing a trafficker or two to please Washington, but U.S. officials were reluctant to share intelligence because some corrupt Mexican officials leaked the information to the cartels. "You have to give Fox credit because he's doing more than all of his predecessors combined," says a U.S. law-enforcement official who has worked with Mexico for years.

Although Fox's war is driven mainly by Mexican fears of rampant lawlessness, he is also hoping that the Bush Administration will reward him by later legalizing the status of millions of Mexicans working in the U.S. With the White House focused on the war on terrorism, that's unlikely anytime soon. But some analysts say it could happen in a second Bush term.

For his sweeping crackdown, Fox is relying heavily on the Mexican military. That may sound odd given the spectacular prosecution of the two army generals. But the army is still much less tainted by

ACOSTA: He drew a stiff prison sentence

corruption than the local and federal police. That's why Fox named a general, Rafael Macedo de la Concha, to head the attorney general's office. He has been instrumental in rooting out corruption and bolstering the staff's investigative skills. "The only thing that had been lacking in this country was political willingness and determination to go after official corruption, which is the biggest problem," says Jesús Blancornelas, the muckraking editor of the Tijuana newspaper *Zeta*, who survived a 1997 shooting by the Arellano Félix gang.

As impressive as Fox's achievements are, law-enforcement officials say the flow of drugs into the U.S. has probably been only minimally disrupted, as smaller gangs pick up the slack from the crippled cartels. Visiting Mexico City in June, John P. Walters, director of the White House office of national drug control policy, said U.S. street prices for drugs were rising, thanks to Mexico's efforts. Yet the \$60 billion U.S. market for illegal drugs remains largely intact. The drug war will never be won. But at least Fox is fighting harder than any other President ever has.

By Geri Smith in Mexico City



FIGHTING MEXICO'S DRUG KINGPINS

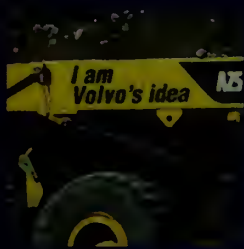
NEW ENFORCERS The Fox administration has created carefully vetted military and civilian investigative teams.

BETTER INTELLIGENCE Mexico's close cooperation with the U.S. Drug Enforcement Administration has led to an unprecedented two-way sharing of information.

SWEEPING CRACKDOWN By striking simultaneously at top leaders of main cartels, Mexico has disrupted the flow of drugs to the U.S.

Data: BusinessWeek

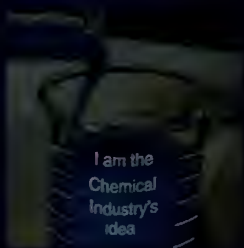
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CAN HORSE-TRADING WIN THE SAUDIS A VOICE ON IRAQ?

In his office high above the sprawl of Riyadh, an influential Saudi official speaks with regret about his government's inability to influence the unfolding confrontation between the U.S. and Iraq. Saudi Arabia, he tells *BusinessWeek*, should be working closely with the U.S. to arrange a post-Saddam Iraq. But instead the Saudis are barely in the picture. "The problem is that we are not cooperating [enough] with the Americans," he notes.

As U.N. weapons inspectors prepare to head into Iraq on Nov. 18, the Saudi royal family is in a quandary over the region's impending conflict. On the one hand, the Saudis wouldn't mind seeing Saddam ousted if he fails to comply with the U.N. But the Saudis fear the consequences of an American invasion, both for the region and at home, where anger at U.S. support for Israel is white-hot and most Saudis oppose an attack on Baghdad. At the same time, the royal family doesn't want to see its already-frayed ties with the U.S. unravel completely. "The Saudis are trying to balance between keeping good relations with the West and a population that is angry and frustrated with U.S. policies," says a Western diplomat in Riyadh.

Above all, the Saudis want to avoid a war, which would make straddling competing interests even tougher. That's why Crown Prince Abdullah is urging Iraq to accommodate the U.N. inspectors. Thus Saudi Foreign Minister Saud al-Faisal's public embrace of the Iraqi Foreign Minister Naji Sabri at an Arab Foreign Ministers' meeting in Cairo on Nov. 9 was a sign of support for Baghdad, and part of Riyadh's campaign to moderate Saddam's response. The big worry, says Turki al-Faisal, former chief of intelligence, is that "Saddam will screw things up." Iraq's leader, he adds, "is blind to logic."

If the Saudis decide they can't stop a war, they may well give more aid to the U.S. than is generally expected. The

unanimous vote for the U.N. resolution on Iraq on Nov. 8, backed even by Syria, will make giving such aid easier. U.S. jet fighters regularly blast off from the Prince Sultan Air Base south of Riyadh for the southern no-flight zone over Iraq. If the U.N. Security Council authorizes an attack on Iraq, the Saudis could allow the U.S. full use of its bases for sorties. But the Saudis might still want "a certain amount of obfuscation" about their role, the Western diplomat says.

Even if they pitch in, the Saudis fear the ripple effects of a military campaign. Al-Faisal warns that an invasion could be "catastrophic" and predicts an Iraqi breakup as a result. In this case, the Shiite Muslim majority in the south and the semi-independent Kurds in the north would seek greater status than they enjoyed under Saddam, whose base is Iraq's Sunni heartland. The Saudis worry that instability could lead to intervention by Turkey or Iran.

But it doesn't look like warning about the war's dangers will stop it. One possible course would be for the Saudis to give access to their bases in return for being brought into planning for the aftermath of the war. Some observers worry that the Saudis have left such discussions until too late. Abdul Rahman al-Rashid, editor of the Saudi-owned, London-based daily *Asharq Al-Awsat*, recently blasted the Saudi decision to send a delegation of businessmen to Baghdad as a futile effort to appease public opinion. "A correct estimate of the future and preparations to face it are much more important than doing things to please angry critics," he wrote in the Jeddah-based *Arab News* on Nov. 10.

Few such voices, though, can be heard in the kingdom. Saudi unease with the crisis is understandable. But Riyadh's dilemma remains: Work with the Americans now, or get stuck later dealing with what they've brought to pass.

By Stanley Reed in Riyadh



ABDULLAH: A delicate task

GLOBAL WRAPUP

A NEW LOOK FOR NATO

► The North Atlantic Treaty Organization is about to launch an ambitious, and difficult, makeover. When heads of state of 19 NATO nations meet for a summit in Prague on Nov. 21-22, they are expected to invite seven more Eastern European nations to become members of the 53-year-old alliance. Estonia, Lithuania, Latvia, Slovakia, Slovenia, Romania, and Bulgaria are all hoping to get the same boost from joining the privileged club as Poland, Hungary, and the Czech Republic af-

ter they became members in 1999. In those three cases, membership was seen as a sign of stability, and foreign investment climbed sharply.

But as a sprawling organization with 26 members, NATO will face a harder time making decisions by consensus—and operating effectively. All of NATO's new members will have to invest heavily to bring their militaries up to the alliance's standards. "NATO is already an irrelevant encumbrance" to some of Washington's top brass, says Sebastian Gorka, a Budapest-based defense specialist who is a frequent lec-

turer at the NATO school in Oberammergau, Germany.

The U.S. largely ignored NATO during its war on Afghanistan. But a Bush Administration official says the U.S. may rely partly on NATO equipment and bases if Washington launches an attack on Iraq. NATO's role in an Iraq conflict is likely to be discussed at the summit. Alliance members are also expected to approve the creation of a 21,000-strong rapid deployment force, which could participate in the fight against terrorism, analysts say.

By Christopher Condon in Budapest

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MEGA EUROPE

The construction of Europe has often seemed more like the building of a great medieval cathedral—a painstaking process that takes generations, and whose final majestic shape can only be dimly imagined by a far-sighted few. True, there were always visionary European leaders who saw the citizens of Germany, France, and Sweden someday swearing double allegiance—to a flag of 12 gold stars on a field of blue as well as to their own nation's colors. But over the decades, the gap between the European Union's vision of itself and the gritty business of uniting a whole continent of cultures often felt as unbridgeable as in those first dark days after World War II, when a few policymakers dared dream of a Greater Europe.

25 states, 450 million citizens. The EU expansion will challenge both East and West

woke up to a new money, the euro. In place of their faded marks, guilders, and francs, they got packets of green-, red-, and blue-tinted euro bills and weighty brass-rimmed coins. Germans, French, Italians, and others could feel the reality of Europe jingling in their pockets.

Monetary union, monumental as it is, is only a prelude. In a move so audacious no one knows whether it will work or not, the West is now set to make

most of the citizens of the old Soviet bloc Europeans. Over the next two years, nations from Estonia in the north to Slovenia in the south will be admitted into the EU after a few final rounds of negotiation. The island states of Malta and Cyprus will join, too. Enlargement—a prosaic word for such an epochal event—marks a true inflection point in modern human history. Proud and ancient states from Portugal to Latvia are voluntarily giving up huge swaths of sovereignty on a scale not seen since Charlemagne tried to unify the continent 1,200 years ago.

Brussels' embrace will add 23% to the EU's land mass and bring in 75 million new citizens, making a new Mega Europe of more than 450 million people. Its economy of \$9.3 trillion will approach that of the U.S. The new entity could easily eclipse America if Europe rediscovers growth. Always primarily a political project, expansion is intended to underpin democracy and free markets in the once-centrally planned dictatorships of Central and Eastern Europe and create a zone of stability on the EU's eastern flank. Yet what Europeans have really wrought will not be known for years. The current leader of this effort, Ro-

Special Report

writing out their psalters, produced binders full of plans and rules for a new Europe to pass on to the next generation. Believe, the acolytes said, and one day it shall happen.

Now, in the course of one short decade, it is happening. In 1992, Europeans got a single market and a standardized European passport, a pocket-size badge of unity. It was the first hard evidence that Brussels might do more than run a subsidy machine for the continent's farmers. Then last Jan. 1, Europeans

KRAKOW The once-dowdy Old Town has become a mecca for tourists

have to go ahead and have faith it's going to work."

That's because expansion is far more politically charged than anything Europe's builders have attempted before. True, the distribution of a common European passport aroused some rump nationalism from folks who hated giving up the passports of the French Republic or Her Britannic Majesty. And the backlash against a European money seemed serious, especially among Germans. Half said they were reluctant to give up the mark—until Jan. 1, when most pocketed the currency with enthusiasm.

But grafting on 10 new European states suggests a much rougher ride ahead. For one thing, unlike monetary union, which was heavily marketed to voters, there has been no selling of enlargement to the masses. Except for the Irish, whose constitution compelled a referendum, no Western Europeans have gotten to vote on it. Now ordinary citizens are wondering what's up. "Deep, basic questions are being asked, and French public opinion polls for one are extremely worrying," says John Kerr, secretary general of the European convention, which is coming up with a working constitution for the EU.

"Would we be in that state

mano Prodi, head of the European Commission in Brussels, recently told associates it "is like the Allied invasion of Normandy—you just

Still, the existing EU economy will grow by an extra 0.2% a year as a result of enlargement, says Prodi. Not bad. But Eurostat statistics show that adding 10 countries will only expand the EU's overall economy by 4.4%.

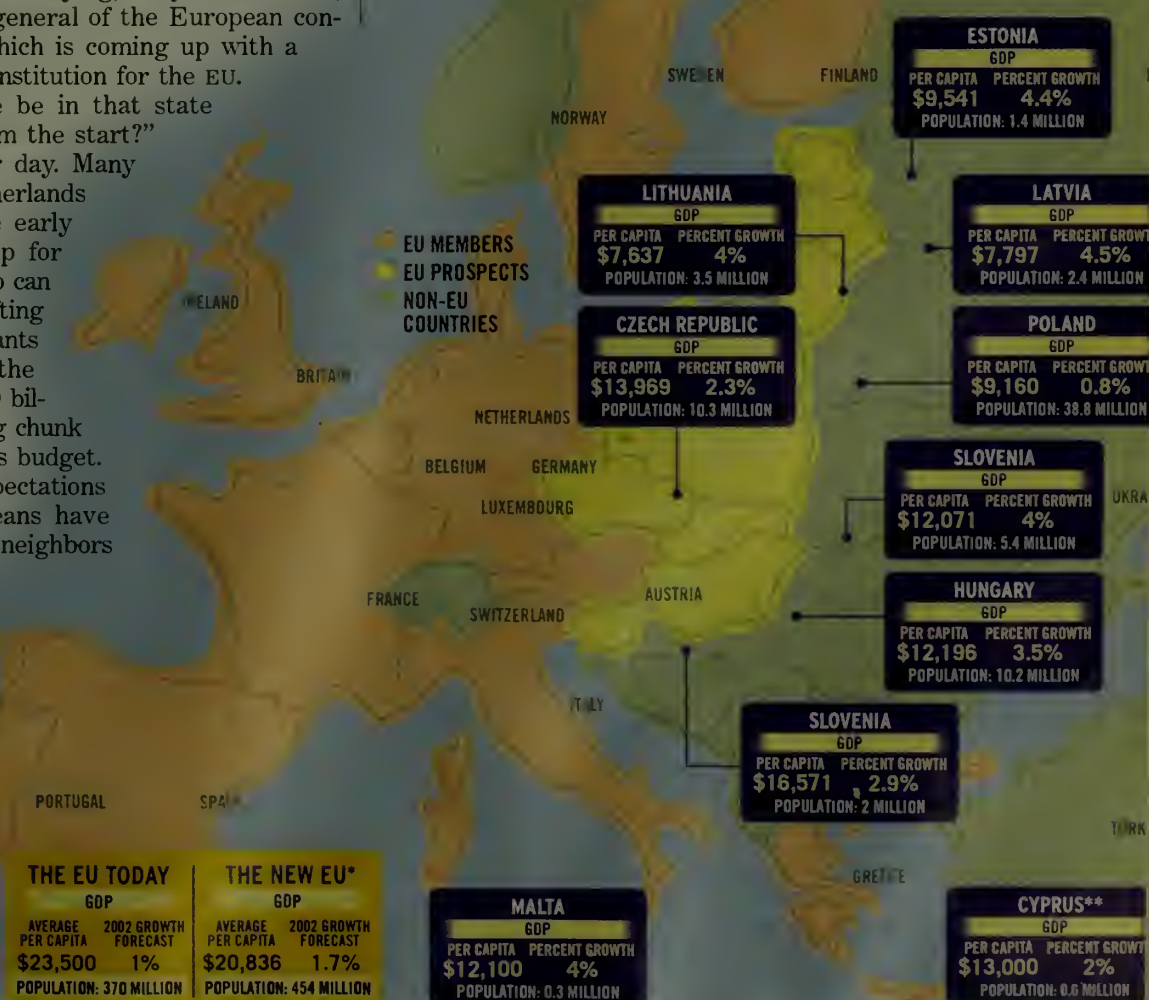
Meanwhile, in the East, countries like Poland, the Czech Republic, Hungary, and the Baltic states envision a rush of investment similar to what some got in the 1990s. Investment will surely come, but multinationals have their pick of low-cost locales around the world. And productivity in the East lags badly. A German worker—the world's priciest at 55 euros an hour—can do the work of four Poles. There is another danger. Expansion could reinforce structural weaknesses that have left Europe with high unemployment and anemic growth. Ideally, Europe would have already reformed rigid labor markets, freed pension systems, and cut corrosively high taxes before embarking on expansion. It hasn't. Instead, "the EU will unfortunately bring a lot of bureaucracy [to Central Europe]," says Volkswagen's former chairman, Carl H. Hahn.

But the bureaucrats are pressing on. The EU has been preparing for this Big Bang since that day in November, 1989, when the Berlin Wall came down. To qualify for membership, candidate countries have had to privatize state assets, deregulate markets, and restructure industries. The candidates have enshrined the *acquis communautaire*, 80,000 pages of complex EU law, in their own legal systems.

For most East Europeans, Ireland and Spain are models for

THE NEW SHAPE OF EUROPE

As the European Union expands east, the economic and demographic profile of the club will change dramatically



what can be achieved by joining the EU. When the Emerald Isle enlisted in 1973, its GDP per capita was less than 70% of the European average and unemployment was almost 17%. Now the country suffers from a labor shortage. "It was joining the European Union that made Ireland rich," says Noreen Aher, an

Irish dairy farmer enjoying a long weekend break in Kraków. Spain, once a backwater, is now one of Europe's most vibrant regions. "[EU

membership] underpinned Spain's success," says Polish Finance Minister Grzegorz Kolodko. "We want it to do the same for Poland."

In the late 1990s, as the East started its run toward EU membership, it looked as though joining the club would indeed generate prosperity. In anticipation of their joining the common market, Western companies—most of them from the existing

EU—invested more than \$80 billion in the candidate countries. The result has been economic growth in the East of 4% to 5% a year, on average, since 1995, far higher than the 2% achieved in Western Europe. Labor productivity, though low, is increasing fast. Economists predict it will grow by more than 7% this year in Latvia and 4.5% in Poland.

Trade with the EU now accounts for more than 60% of the GDP of each future member. Western companies, such as Siemens and French yogurt king Danone, have integrated their Eastern subsidiaries into global international supply chains. Sleep in a Berlin hotel, and the odds are the bed linen will be laundered in Poland. Eat in a Vienna restaurant, and many of the waiting staff will be from Slovakia. As a result, the candidate countries' economies have started to converge with the EU's. But it's a slow process. One indicator produced by Deutsche Bank measures convergence based on GDP growth productivity, and a range of other economic factors. It will

Special Report

MEGA EUROPE

HUNGARY

NO HUNGARIAN RHAPSODY FOR GE

How do you play your hand after the game has changed? That's the question General Electric Co. is pondering as the final countdown for European Union enlargement begins. The answer will certainly influence other foreign companies as they consider whether to remain in Eastern Europe or seek out cheaper locales.

After the collapse of the Iron Curtain, few multinationals leaped into the region with more gusto than GE. The U.S. powerhouse has plowed \$1.1 billion into Hungary in the past 12 years, making it one of the country's largest investors. In that time, GE has turned around a state-owned dinosaur, built three new plants, and recruited dozens of scientists.

Yet the Hungary that GE discovered more than a decade ago bears little resemblance to the country now on the brink of joining the EU. The economy is more stable, the legal and regulatory environment is more transparent, and local suppliers are more reliable. But doing business here is getting more expensive with every passing year, as wages rise and as officials are forced to phase out big tax breaks to comply with EU rules. IBM will shut one factory at the end of November, and Flextronics Corp. has moved hundreds of jobs to China.

GE says it has no plans to pull up



BETTING BIG ON HUNGARY

Leading foreign investors*	
COMPANY	TOTAL INVESTMENT (Millions)
DEUTSCHE TELEKOM	\$1,727
GENERAL ELECTRIC	1,100
VOLKSWAGEN	1,012
E.ON	916
RWE	660

* As of August, 2001. GE figures are through 2002

Data: Budapest Business Journal

stakes. "The changes don't make me think of Hungary as a more difficult place to invest, as long as the people and the government know they have to be competitive," said GE Chairman and CEO Jeffrey R. Immelt during a visit to Budapest last month. Yet many observers expect GE to leave the lighting business, which is the heart of the Hungarian operation. GE would not comment on such speculations.

EU membership seemed a long way off in 1990, when GE Lighting

bought Tungsram, a dilapidated, state-owned lightbulb maker. GE Lighting later transferred to Budapest its headquarters for Europe, the Middle East, and Africa, along with three research and development centers. GE Power Controls, GE Power Systems, and GE Engine Services also have factories in Hungary. Some investments, such as the 1995 acquisition of troubled Budapest Bank, have underperformed. Excluding the bank, GE Hungary posted a \$65 million net profit in 2001, a 1% decline from the previous year, on \$790 million in sales.

GE is taking the changes in stride. Istvan Szini, managing director of the Hungarian operation, claims much of the ground lost to wage hikes can be recouped by efficiency gains. Productivity has been rising by an average of 7% to 8% a year at GE's local consumer-lighting unit. Besides, the company is keen to exploit Hungary's comparatively high levels of education. On Oct. 24, GE announced that it was spending \$4.6 million on a Budapest office that will house a customer-service center, as well as back-office operations for GE units across Western Europe. The center will employ 500 people.

The new investment pleases Hungarian officials even more than new assembly lines. "We have to focus on creating jobs with more added value, and this is a perfect example," says Hungary's Finance Minister Csaba Laszlo. Especially when a giant like GE needs new reasons to stay committed.

By Christopher Condon in Budapest

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take Slovenia, the most developed country, up to a decade to catch up with the EU average. The economic gap between most of the candidate countries and the EU average is far bigger than it was for previous newcomers. "It could be 40 years before Poland reaches average EU living standards," predicts Willem H. Buiter, chief economist of the European Bank for Reconstruction & Development (EBRD) in London. One problem is that the new members can expect far smaller handouts from Brussels than the likes of Spain and Ireland received. Sure, Eastern farmers will get their subsidies—but they'll only get 25% of the EU level in 2004 and won't reach parity until 2013. Other grants will be capped at 4% of a candidate country's GDP, compared with 8% for previous new members.

Many Eastern business-

Special Report

MEGA EUROPE

es will be given a new lease on life when the final trade barriers separating them from Western markets finally come down. Selling to the existing EU will be even easier after 2006, when the first new members can start converting to the euro. One company poised to do well is Media Menu, an Estonian information-technology company focusing on Internet-based solutions. It can undercut prices of its EU competitors because labor costs in Estonia are one-sixth those in Finland.

But for every Eastern European winner, there could be a loser. Western manufacturers may have higher costs. But they also tend to have productivity levels twice as high as they are in the East, as well as savvy distribution skills. "We could be crushed by them," says Philips Gunnars, who runs a small meat processor on the outskirts of Riga.

In theory, joining the EU should make countries even more attractive for investors, because it confirms them as stable democracies and low-cost market economies. Executives at German conglomerate Siemens, which employs 12,000 people in the Czech Republic, 6,000 in Slovakia, and 5,000 in Hungary, notes that the overall cost of employing a Czech work-

THE CZECH REPUBLIC

MINICAR MUSCLE

When PSA Peugeot Citroën and Toyota Motor Corp. announced plans in July, 2001, to build an assembly plant in Europe, more than 20 towns stretching from Portugal to Turkey rolled out the red carpet. After sifting through pitches offering everything from tax breaks to dirt-cheap labor, the partners settled on the Czech town of Kolin.

Kolin lies less than 100 miles from the German border, yet labor costs there are less than half those in Germany. Skilled engineers are plentiful, thanks to the country's numerous universities and technical institutes. Moreover, the Czech Republic boasts a long auto-manufacturing tradition: The country is home to 97-year-old Skoda, which was acquired by Volkswagen in 1991. Another key factor:

With EU membership likely in 2004, Peugeot and Toyota can look forward to the dismantling of nontariff barriers to trade between East and West. "We looked across Europe, and the Czech Republic was the right place," says Denis Duchesne, regional managing director of PSA Peugeot Citroën.

Car bosses like Peugeot's Jean-Martin Folz and Toyota's Fujio Cho are making a major bet that eastward expansion will eventually yield hundreds of millions in extra revenues. Nowhere is the magnitude of that bet more visible than in the Czech Republic, which in the past decade has overtaken Poland to become the region's top producer of cars and light trucks.

The \$1.3 billion Franco-Japanese joint venture will produce Toyota-, Citroën-, and Peugeot-badged cars using the same platform, or underbody. The tiny vehicles will have price tags to match: All will sell for under \$8,000. More than two-thirds of the plant's output will go to Western Europe, where there is a growing appetite for fuel-efficient minicars,



THE ROAD AHEAD: Peugeot CEO Folz breaks ground

such as Daimler-Chrysler's Smart. And the Czech Republic's location and its improving roads will facilitate exports. "Kolin offers a big advantage in terms of transportation costs," says Masatake Enomoto, president of the Czech venture.

For real penny-pinchers, Kolin may not look like the best deal, though. Czech workers already earn more than three times those in Romania, and their wages are rising. But Czech productivity is a compensating factor. VW has introduced Western quality controls and work habits to the area's labor force. In a new J.D. Power & Associates survey of German customer satisfaction, the \$10,000 Skoda Fabia came in second only to the Toyota Yaris in the compact category. Toyota and Peugeot are confident of emulating VW's success. "It's not only the economic factors but also the reliability of the people," says Duchesne. Peugeot is upping the ante. On Oct. 28, the company said it will pour \$700 million into a new assembly plant in Central Europe to crank out at least 300,000 cars a year. You can bet the Czechs will be bidding.

*By Christine Tierney
in Prague*

CZECH YOUR ENGINES

Partners Toyota Motor, PSA Peugeot Citroën

Site Kolin, Czech Republic, 33 miles east of Prague

Investment \$1.3 billion

Production capacity 320,000 cars a year

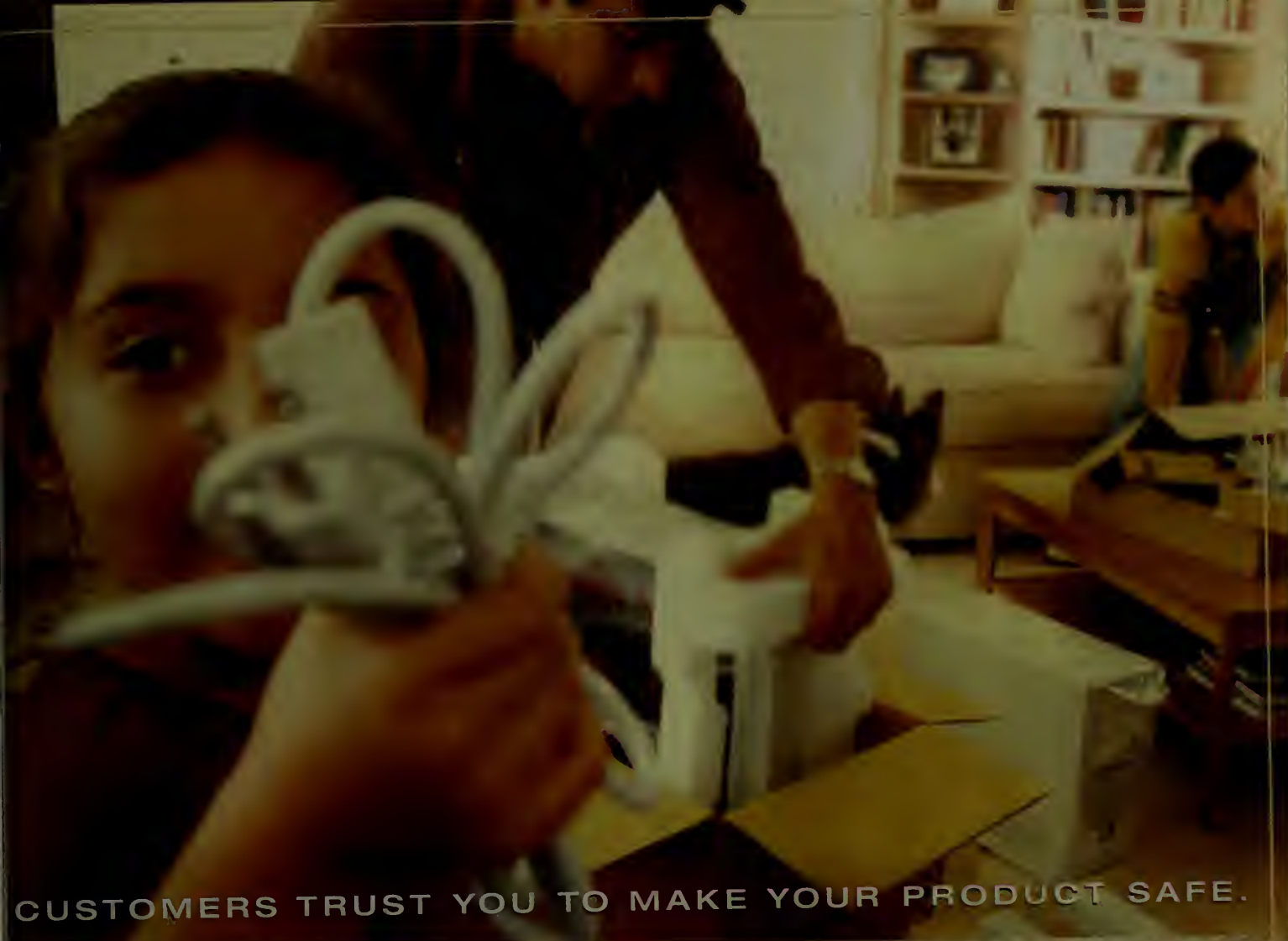
Startup date 2005

Total workforce 3,000

Data: Company reports

er is just a third the cost of a German. But whether the candidate countries can continue sucking in investment on the scale they need to plug yawning current account deficits—Latvia's will top 8% this year—is an open question.

Workers in the East will not simply sit on their hands while these issues are resolved. Although free movement of labor between new and existing member states won't be allowed until 2007 at the earliest, cheap Eastern labor has al-



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ready flowed into the EU. The entrepreneurial zeal of workers is matched by the liberalizing drive of governments. The Eastern newcomers have embraced deregulation with more fervor than the West. Poland's banks, for example, are profitable, efficient, and almost wholly privatized. Germany's are burdened with rising bad debts, high costs, and the presence of state-owned rivals that distort competition. "The hope is that the

Special Report

MEGA EUROPE

newcomers will act to spur reform," says the EBRD's Buiters.

Yet the opposite may happen. Swedish entrepreneur Arne Ostlin runs Ostlins, a fish smokehouse in Stugsund, a village three hours north of Stockholm. He recalls that when Sweden joined the EU in 1995, Swedish food businesses had to be approved anew by Brussels. "I already filled out all these forms here, then I had to fill them out again. If I

do all of this, I won't have time for business," he says.

The complaints and fears are sure to mount as the date of expansion approaches. But Brussels mandarins take the long view, and count the political gains of union as already won. Others must still struggle in the new Europe. Jerzy Bis, a 39-year-old Polish miner, spends his days pounding the pavement in Kraków, looking for any work. "What we need is more investment to get the economy moving," he says. "Joining the EU might give us that." Will the EU deliver that job to Bis and other hapless workers? Can Europe ultimately afford the great experiment? Those remain the final, essential questions.

By David Fairlamb in Brussels, with John Rossant in Paris and bureau reports

BusinessWeek online

Q&As, additional stories, and more are available with the Nov. 18 issue online at www.businessweekasia.com

RUSSIA

A BEAR HUG: RUSSIA CAPITALIZES ON EU EXPANSION

Europe first expanded to the East to counter a Russian threat.

From the time the Berlin Wall collapsed, former Soviet bloc countries longed to join Western Europe's privileged clubs, the European Union and NATO. For Eastern European and Baltic nations, membership offered not just economic benefits but a sense of security—in case the Russian bear turned threatening again.

Well, Europe is creeping ever closer to the bear—so close that the former Soviet republics of Estonia, Latvia, and Lithuania will soon be EU members. That's fueling bitter complaints from Russian nationalists. And controversy has erupted over the Russian enclave of Kaliningrad, which will be completely cut off from the rest of the country when neighboring Poland and Lithuania join the EU. The EU's eastward expansion reflects "a continuation of Cold War mentality," argues Alexei Mitrofanov, a right-wing Russian legislator.

But the nationalists do not represent all of Russia. Powerless to put a halt to enlargement, Russia's pragmatic boss, Vladimir V. Putin, is instead trying to capitalize on the EU's new proximity. "Our priorities [are] firmly



GUSHER: A Siberia-to-Europe gas line crosses Poland

in the direction of Europe," Putin declared in his annual address to the nation earlier this year.

Many Russians agree: A recent poll showed 52% think the country should eventually join the EU.

By embracing Europe, Putin is following the model set by Russia's first great modernizer, Peter the Great, who opened the country to the West. Although Russia has no immediate plans to apply for EU

membership, Putin envisions what he calls a "single economic space" in Europe: a free-trade zone stretching from Glasgow to Vladivostok. Russian multinationals could be big players in this market, while European companies would pour investment into Russia.

It's not an outlandish scenario. The EU is Russia's biggest trading partner, absorbing some 35% of exports, notably oil and gas. That figure will rise to more than half after the 10 new members join the EU. Energy giants Yukos Oil Co. and Lukoil view Europe's expansion as a chance to build on investments in refineries and gas stations in Bulgaria, Romania, or Lithuania. "We see it as an economic opportunity," says Hugo Erikssen, director of international relations for Yukos, which has refineries in Lithuania.

Meanwhile, Gazprom is building a new pipeline to ship gas to the expanded EU.

Of course, it would take years for Putin to realize his vision of a free-trade zone linking Russia and the EU, if it can happen at all. So far, Moscow hasn't taken even the first steps necessary to meet Putin's goal of joining the World Trade Organization by 2003, such as opening its financial services and telecom sectors more to foreigners. And it's likely that former Soviet bloc countries, still worried about the old bear, won't want to rush to integrate economically with Moscow again. But for the heirs of Peter the Great, the lure of the West is proving more powerful than ever.

By Catherine Belton in Moscow, with David Fairlamb in Frankfurt

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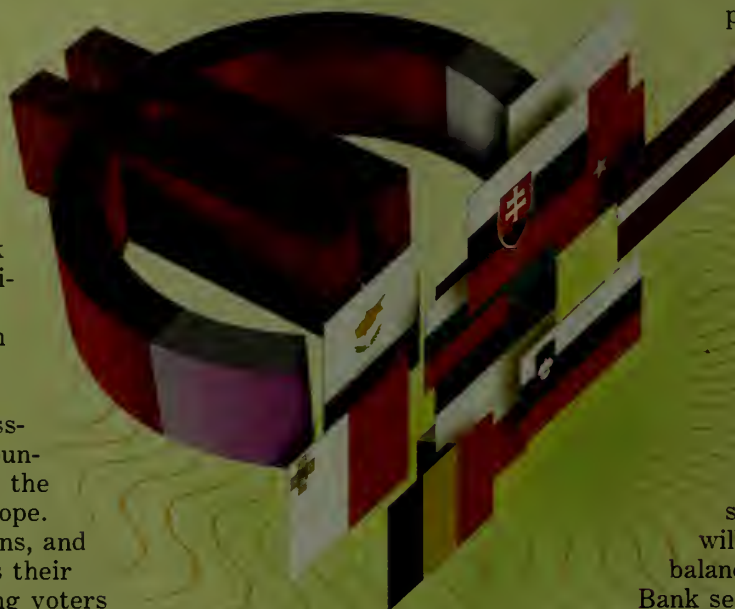


By Bob Dowling

WHO REALLY SPEAKS FOR EUROPE

In late August, a group of scholars, technocrats, and economists from around the world gathered in a castle outside Salzburg, Austria, to debate the future of the euro. Amid torrential rains that kept everyone hunkered down inside, the talk soon turned global. The Taiwanese, Koreans, Vietnamese, Chinese, and Latin Americans wondered if a euro-type currency could ever work for them. A Russian economist hoped her country would eventually adopt the euro to lock itself into Europe. The Czechs, Poles, Estonians, and Bulgarians saw the euro as their best selling point for getting voters to join the European Union. The magnetic attraction of the euro was clear.

Then came a surprising conclusion. The guests of the Salzburg In-



stitute, a European think tank, agreed that changes like the euro and EU enlargement are seldom justified on economic grounds. They are really political moon shots cleverly marketed as economic breakthroughs to goad change, rather than build on it. Thus the euro was supposed to cap a new, streamlined European economy. Instead, it has become a potent symbol of Europe and what it could be. "All the economists were against it. If we had listened to them, the euro would never have happened," says Michel Petite, the European Commission's top lawyer, who wrote the euro rules.

Europe's enlargement plan is the same kind of political bet. At stake is whether Europe becomes a diverse, competitive, high-growth region or a much broader social welfare state with new petitioners banging on Brussels' door. The answer may not be known for years.

Europeans have some big choices ahead. One is to use the new states as a lever for change. That means scripting flexibility into economic

politics so that new countries can carve out their own path. The nations of the East are young, high-growth economies that could become vibrant competitors. But it has been hell for them to manage their spending and currencies over the past decade. Poland has had nine governments since 1989, and most have fallen because farmers, unions, and other special interests demanded bigger subsidies. Even ardent reformers are throwing up their hands. "I want to join the euro because it is the only way I can control our runaway spending," says Polish central bank head Leszek Balcerowicz.

The new states will use Old Europe's stringent budget rules to beat their spenders into submission, just as Spain, Belgium, and Greece did a few years ago. The reward for less spending would be lower interest rates. But there's a big trade-off. They also would have to opt into western Europe's own expensive model of the welfare state—not long after slipping out of the Soviet eco-

mic noose. For Poland, a 6%-per-year growth tiger in the mid-1990s, this transition could be devastating. On the other hand, if the new states persuade Frankfurt and Brussels to lighten up, they could be allowed to break deficit limits in the short term to get growth going. The EU already is allowing Old Europe countries temporarily to exceed budget deficit limits of 3% of gross domestic product and to stretch out the time they will have to get budgets in balance. The European Central Bank seems poised to cut rates even though inflation remains above target.

Another outcome could be perpetual conflict between the new states and their rich neighbors. German labor unions want to help their counterparts in the East get their wages up to preserve German jobs. Greens want industries in Eastern Europe to abide by environmental controls every bit as strict as those in the West. Old Europe's farmers hope a new farm lobby from the East will help keep generous agricultural subsidies flowing. And who knows what Brussels would do if the new members cut taxes far below Western levels in order to draw investment.

For those watching this mélange from outside Europe, the best advice is to take a deep breath and wait. The Continent's politicians won't be derailed by lecturing. As Europe gets larger, it's likely to become increasingly absorbed with itself and tone deaf to outsiders. European Commission President Romano Prodi regrets in an interview that the U.S. isn't paying much attention to Europe. There's a reason for that. Until Europeans decide whether they want to socialize the young economies of the East or compete head-on with the them, there isn't really much to say.

Dowling is managing editor of BusinessWeek International.

As the euro zone grows, will market forces or socialization rule the day?

Special Report

MEGA EUROPE

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EDUCATION

WHY JOHNNY CAN'T FAIL

New test standards leave states plenty of wiggle room

For decades, U.S. schoolkids have chewed nervously on their No. 2 pencils as they sweated over multiple-choice exams. Now, testing fever is about to spike. States are beginning to put into practice the No Child Left Behind Act, the sweeping education law George Bush signed last January. The decisions each state makes about how to proceed with the bill's mandates will determine whether it improves the education children receive—or actually lowers educational standards.

The scramble to meet the law's ambitious goals is already under way. States are required to test the math and English proficiency of every child in grades three through eight, which must begin no later than 2005. Each year thereafter, schools must show progress on their test scores, including those of poor and minority students. Those that fail to improve will be subject to escalating penalties, ranging from being forced to bus their

students to better schools to having their administrations tossed out. The idea: Use testing to shine a light on what students are learning and to prod schools to do better.

The concept is simple, the execution anything but. Because each state—not Washington—gets to decide what proficiency means, it can in effect decide just how many schools are “failing.” States also get to choose which testing system to use. If they follow the advice of most education experts, state officials will devote lots of time and money to designing high-quality tests that reflect the classroom curriculum and well-studied proficiency standards. A handful, such as Maryland and Massachusetts, are doing just that (table, page 90).

But at a time of budget crises from Albany to Sacramento, many education

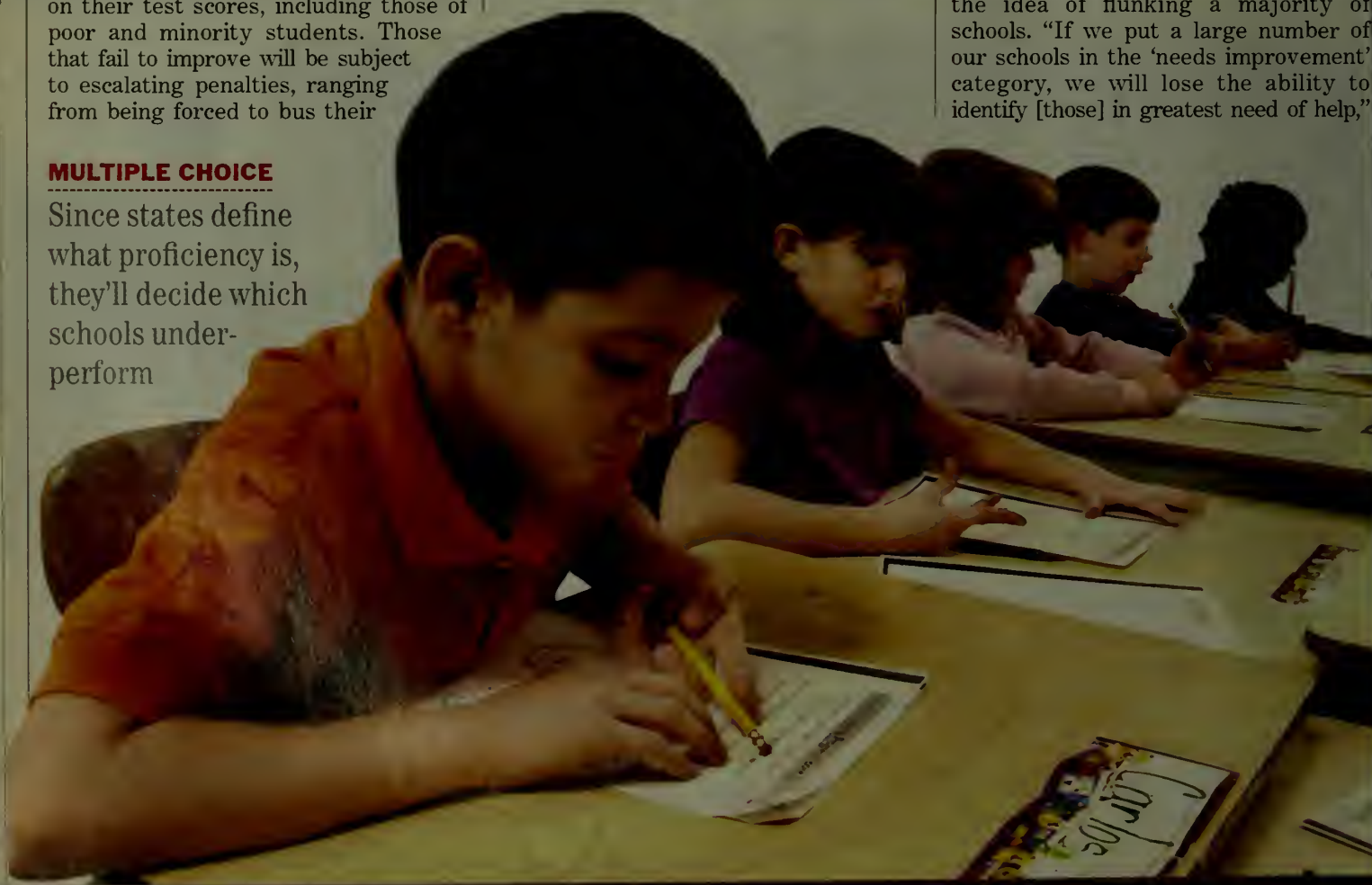
departments are under pressure to take a quicker, less costly approach. With education budgets already under the knife, there are few extra funds to improve classroom—and test score—performance.

Facing an aggressive timeline, state educators are setting standards that won't cause too many students to fail on the upcoming tests. Connecticut, for example, recently set its benchmarks so that 80% of students will pass its tests under the new federal guidelines. Louisiana and Colorado are following suit, while Wyoming set its proficiency goals so low that not a single school in the state is failing. Such moves prompted Education Secretary Rod Paige to fire off a blistering letter to the nation's school commissioners in late October, saying: “Some states have lowered the bar of expectations to hide the low performance of their schools. This is not worthy of a great country.”

Yet even as Paige exhorts the states to bolder action, he isn't saying how they should pay for it. The new law provides just \$490 million a year in added funding to help states cope with the extra testing costs. Some state officials say that won't cover the expense of creating higher-quality exams, but with the GOP now firmly in control of Congress, Senate Democrats aren't likely to prevail in their attempts to find more money. States also question the idea of flunking a majority of schools. “If we put a large number of our schools in the ‘needs improvement’ category, we will lose the ability to identify [those] in greatest need of help,”

MULTIPLE CHOICE

Since states define what proficiency is, they'll decide which schools underperform



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Social Issues

says Jack McCoy, head of testing at New Mexico's education department.

While the new law doesn't explicitly prohibit a race to the bottom, it does hold out the stigma of shame for states that go that way. Because every school must publish its test scores, parents will have a much better idea if their school lags behind others in the state. In addition, states must give the National Assessment of Educational Progress (NAEP) exam to a random sample of students every three years. So it will be obvious if many kids in a state fail the national exam but sail through on the state one. "There is nothing we can do to prohibit [states from setting low standards], but we can make things very public," says Federal Assistant Secretary of Education Susan B. Newman.

No question, it's a challenge to re-tool an entire testing regime. The first step is defining what students should know in each grade, as most states already have done. Next, states will need custom-designed tests, as well as the curriculums, to reflect these standards. It can take years to develop such exams, which can run up to \$68 a student. By contrast, cheaper, off-the-shelf tests offer only a broad evaluation of what students should know at their grade level. Some experts also say they're more likely to prompt teaching to the test, since such exams aren't closely aligned with curriculums.

The new law doesn't allow states to simply buy ready-made tests without some tinkering to make them reflect classroom work. But some states, given the financial and time pressure, are inclined to do the bare minimum. West Virginia, for example, spends less than \$2 a student on exams, according to the Education Commission of the States. "Given the current economic climate, there's a concern that states will have to fall back

TESTING: THE STATES' DILEMMA

The No Child Left Behind Act that President Bush signed early this year mandates annual testing for all third- through eighth-graders. States can decide whether to spend a lot, use cheaper approaches that may bring fewer educational gains—or simply muddle along in the middle:

THE HIGH-COST APPROACH



THE LOW-COST APPROACH



STANDARDS

States like North Carolina set clear, specific standards in core subjects that reflect what students should know at their grade levels.

Connecticut has watered down its standards so more students will pass the tests and meet federal guidelines. Wyoming set its guideposts for what children should know at low levels so that no single school is failing.

TESTS

Exams are custom-designed to fit state curriculums and standards, as in Maryland.

Exams are predominately off-the-shelf and measure broad skills, instead of specifically reflecting state standards and curriculums.

COST

Well-designed tests run up to \$68 a student, as in Massachusetts.

West Virginia spends \$1.46 per child on its tests.

Data: BusinessWeek,
Education Commission of the States

on the commercial publishers" that design the ready-made tests, says Margaret Goertz, co-director of the Consortium for Policy Research in Education at the University of Pennsylvania. (Most major test companies, including Houghton-Mifflin Co. and McGraw-Hill Companies, parent of *BusinessWeek*, offer both custom-designed and generic exams.)

Even with all the leeway they have, states won't be able to dodge some reforms. For example, they now must break out test results by race and income status. If any subgroup fails the state "proficiency" standards, the entire school will fail. Since poor and minority kids traditionally score lowest on tests, even middle-class schools may fail if they can't bring

those kids along. Many educators think the embarrassment alone may goad schools to focus more on these groups. "For too long, these kids were forgotten," says David P. Driscoll, commissioner of education in Massachusetts, which already disaggregates scores.

One big loophole in the new law: Its penalties only apply to the 58% of public schools that receive Title I federal funds for poor students, leaving little leverage over the other 42% of schools. And even with the 58%, experts doubt the Bush Administration actually will impose penalties such as removing a school administration, for example. After all, education in America remains locally funded and controlled, and Washington, which only pays for 7% of all schooling costs, isn't looking to control more of it. "There's a political problem with how far the federal government can push" the new sanctions, says John F. Jennings, director of the Center on Education Policy in Washington, D.C.

Overall, there's broad agreement that the new law has the right goals. But it remains to be seen whether the act will spur states to pursue them with vigor—or simply game the system to avoid the stigma of failure.

By Alexandra Starr in Washington

FREE PASS

Schools that don't get Title I funds—some 42%—aren't subject to federal penalties





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RETAILING

HAS TARGET'S FOOD FORAY MISSED THE MARK?

Its supercenters may be too far away to lure frequent shoppers

Amy Olson can't help but be impressed as she strolls the aisles of a new SuperTarget store in St. Charles, Ill., passing a white-clad server dispensing roast beef samples on a silver platter and mountains of exotic cheeses. It's the same merchandising flair the 28-year-old small-business owner has come to expect from Target Corp.'s discount stores. She almost always pops over to the grocery section when she visits Target. But she's not about to ditch her local supermarket. When it comes to food, better deals and a shorter drive trump SuperTarget's elevated shopping experience. "It won't replace my weekly grocery store trip," she says.

That's bad news for Target, which embarked on its grocery strategy as a way to wring more growth out of its all-important Target chain. The discount has been one of the few to thrive in the shadow of the Wal-Mart Stores Inc. juggernaut. It does so by offering an array of affordable products by such chic names as Mossimo and Michael Graves. With its cool assortment, Target doesn't have to beat super-efficient Wal-Mart on price.

But that formula isn't working with groceries. Wal-Mart pioneered the idea of coupling a discount store with a supermarket and has become the nation's No. 1 grocer. But while Wal-Mart's Supercenters lure shoppers back 3.1 times a month, SuperTarget's shoppers visit only about 2.1 times a month, not much more often than they head to regular Target stores, says researcher Service Industry Research Systems Inc. Promotional ties to the likes of celebrity chef Ming Tsai, fresh-daily sushi, and gourmet bread haven't been enough to convert shoppers

such as Olson into regular customers.

The Minneapolis-based retailer would not comment on its combination stores except to say they have sales that are 50% to 100% higher than its standard stores. That may be, but in the war for

market share, Wal-Mart Supercenters are besting SuperTargets. Each Supercenter, on average, held steady at 4.5% share of the local market in 2001, according to retail monitor Metro Market Studies. The average SuperTarget's share, however, dropped to 1.35% from 1.9% the prior year. Analysts expect Target's earnings to rise 15% this year, but to keep that up long term, it will need to augment its discount stores.

But food may not be the answer. Target has opened just 82 SuperTargets since 1995, and new openings will account for just 25% to 40% of square-footage growth next year. Wal-Mart, meanwhile, has opened 1,243 Supercenters since 1988, and the format will account for about 210 of 335 openings next year. "If Target was winning, they would speed it up," says John Watkins of food brokerage Acosta Sales & Marketing Co.

Why are SuperTargets missing the bull's eye? For starters, they're located in more urban areas, where expenses are higher, customers won't drive as far because of traffic, and grocery rivals are more entrenched.

They're also spread out geographically, forcing Target to rely on outside distributors. That adds two or three percentage points to Target's cost of goods in a business with carpaccio-thin margins.

And while the stores' lush look is appealing to customers, it doesn't necessarily stimulate big spending. "They're pretty, almost to the point of being untouchable," says a former

Target exec who worked on its entry into food. Meanwhile, pricing surveys by UBS Warburg suggest Wal-Mart Supercenter prices are 20% to 25% lower than those of national supermarket chains, while SuperTarget prices are just 8% lower. That's not enough to overcome the inconvenience of a longer drive.

Groceries were supposed to be a new growth engine for Target's successful discount stores. So far, though, the recipe that worked so well in merchandise is falling flat when it comes to food.

By Robert Berner in St. Charles, Ill., with Gerry Khermouch in New York and Wendy Zellner in Dallas



A One-Sided Battle

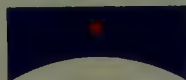
	TARGET	WAL-MART
NUMBER OF SUPERCENTERS	82	1,243
SUPERCENTER SALES	\$4.35 bil.	\$80 bil.
LOCAL MARKET SHARE*	1.35%	4.51%
PLANNED OPENINGS**	30-35	200-210

*Per store in 2001 **In 2003

Data: Prudential Securities Inc., UBS Warburg, Salomon Smith Barney, Metro Market Studies

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HUMAN RIGHTS

MAKING A FEDERAL CASE OUT OF OVERSEAS ABUSES

An obscure law paves the way for suits against multinationals

Should U.S. multinationals be held liable for the human-rights abuses of foreign governments? Victim advocates charge, for instance, that Burma's military rulers forced peasants at gunpoint to help build a pipeline for Unocal Corp., torturing and killing those who resisted. The company knew and approved, they claim. Unocal denies it.

This emotional issue lies at the heart of a dozen lawsuits that seek to hold companies liable if they work with repressive regimes. Plaintiffs in several of these suits, including the one against Unocal, recently have made strides in establishing legal grounds for such claims under an arcane 1789 statute called the Alien Tort Claims Act. Early courtroom victories have set off alarms among business groups, which worry that the likes of IBM, Citibank, and Coca-Cola may be socked with huge jury damages for the misdeeds of Third World governments. Ultimately, up to 1,000 U.S. and foreign companies could be named as defendants in the pending suits, experts on both sides say.

To head them off, business groups have called a closed-door strategy session in Washington on Nov. 18 to consider everything from possible legislation to filing a slew of *amicus curiae* briefs. Already, some companies have been lobbying the Justice Dept. to intervene. Last summer, the State Dept. warned a judge that a case against Exxon Mobil Corp. in Indonesia "could potentially disrupt" the fight against terrorism and should be dropped. Business groups fear that further plaintiffs' successes could chill U.S. companies' activities around

the globe. "Large jury awards will send a message that if you are going to do business in a country where the government is violating human-rights or labor standards, you may be sued," warns J. Daniel O'Flaherty, vice-president at the National Foreign Trade Council, which represents U.S. exporters.

The Alien Claims act on which the suits are based was originally intended to reassure Europe that the fledgling

U.S. wouldn't harbor pirates or assassins. It permits foreigners to sue in U.S. courts for violations of "the law of nations." It remained little used until 1976, when a Paraguayan doctor brought suit in U.S. court against a former Paraguayan police official for the murder of the doctor's son. In 1980, a federal appeals court ruled that the law allowed foreigners to bring suit in U.S. court over acts committed abroad.

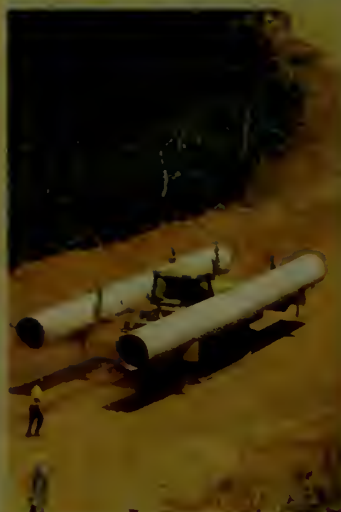
In the early 1990s, human-rights lawyers began applying the law to U.S. corporations. Their contention: that companies can be liable for aiding wrongdoing by authorities or can be "vicariously liable" for the damages caused. For example, a Colombian labor union has brought a U.S. lawsuit against Coca-Cola Co. for allegedly hiring paramilitary units that murdered union organizers. And South Africans have sued Citigroup and other as-yet-unnamed

companies for allegedly profiting from apartheid. "These lawsuits hold the corporate world responsible for the ultimate actions of what their products and money do," says Edward Fagan, a New York lawyer helping the plaintiffs.

Human-rights activists think they have the best shot in the Unocal case. It was filed in Los Angeles in 1996 on behalf of Burmese citizens who claim that the California energy giant used the army of Burma to force villagers to clear jungle for the company's natural-gas pipeline. A lower court dismissed the case, but in September the often liberal Ninth Circuit U.S. Court of Appeals reinstated it. The court suggested that Unocal could be liable if it "provided practical assistance or encouragement" to the Burmese military—or even if Unocal simply knew that crimes were occurring.

The case still faces plenty of legal hurdles, but it has progressed to the point where Unocal may soon have to face torture survivors in court—a publicity nightmare. If that happens, activists are sure to be emboldened to bring more grievances to U.S. courts.

By Paul Magnusson
in Washington



Did Unocal know about Burmese forced labor?



Will suing ExxonMobil abet Indonesian terrorists?

HUMAN RIGHTS: ARE COMPANIES RESPONSIBLE?

U.S. employers are worried about more than a dozen lawsuits alleging abuses in countries where they operate. Some prominent cases:

- ▶ The U.S. Court of Appeals for the Ninth Circuit recently allowed citizens of Burma to proceed with a case accusing Unocal of knowingly using forced labor supplied by the Burmese military
- ▶ The Bush Administration, worried about terrorism, has asked a federal judge to halt a lawsuit alleging that ExxonMobil hired Indonesian troops who committed widespread human-rights abuses
- ▶ Suits filed in federal court in New York and New Jersey accuse IBM, Citigroup, and others of benefiting from apartheid in South Africa

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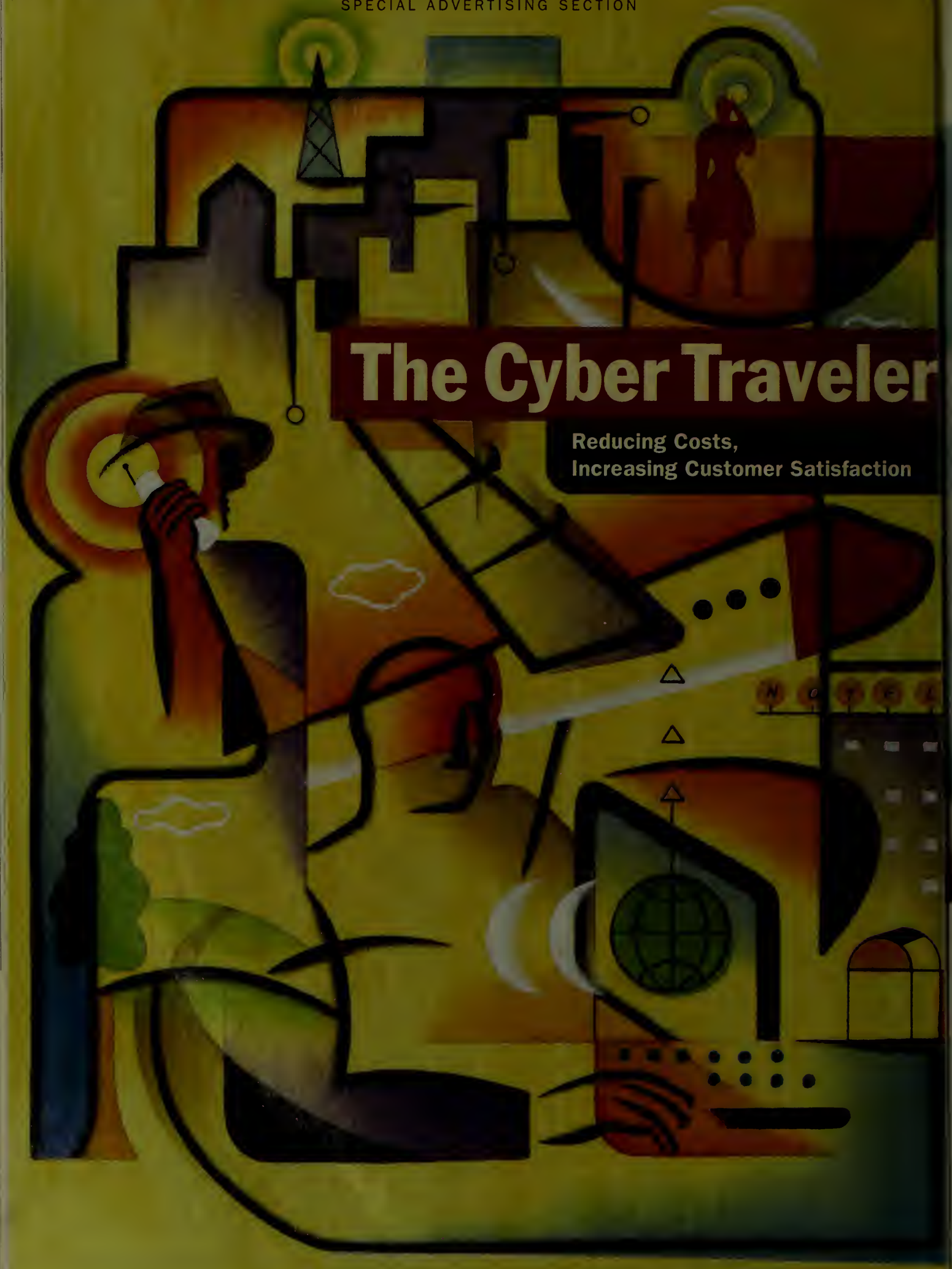
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Reducing Costs, Increasing Customer Satisfaction

If there's one area where B2B electronic commerce has lived up to its potential, it's in travel. Online purchasing – of airline tickets, hotel rooms, rental cars, and even more esoteric items like event tickets and luggage transfers – has skyrocketed, up triple digits every year in the past five years. Corporations are finding that using the

Web streamlines travel management processes covering everything from bookings, finding destination information and facilitating more efficient expense report reconciliation. Meantime, travel suppliers are using the Web to improve service and client communications, and to slash costs, theirs and their clients.

Innovations in the World of E

Today's e-travel doesn't just mean you can make reservations on the Web. Travel technology developers, working in concert with travel suppliers and aircraft manufacturers, are teaming up to deliver important new applications that vastly improve the travel experience:

Air France's Web site, airfrance.com, has undergone a complete overhaul, making it exceptionally user-friendly and feature-rich. Product offerings are updated in real time with up-to-date information on products, flight schedules, flights in progress, fares, destinations etc. A travel planning section includes useful information on visas, airport maps, schedules and airport transfer information. New, is the best fare search, which offers up to five fare offers for all flights during the requested period. The site also provides a list of Internet-only fare specials for destinations in continental France. Frequent travelers? Not only can Air France Fréquence Plus members check their Miles on the site, but can book their reward tickets online as well. Fréquence Plus members can use the interactive voice server to check in for their flights departing from France.



One of the last Internet-free places, the aircraft, is about to go online. German carrier **Lufthansa** is the launch customer for Connexion by Boeing – the aerospace company's unit bringing Internet and data connectivity to aircraft during flight. With Connexion by Boeing utilizing existing satellites to provide broadband coverage, Lufthansa plans to have broadband Internet connections on all long-haul flights by mid 2004. Lufthansa is gearing up for the first trial in January 2003, with plans to follow it with a staged rollout of services. Meanwhile, Lufthansa is planning to install dataports for mobile devices in all classes.

Yatra, a B2B corporate travel marketplace, pools participating companies into a single, powerful "virtual buyer." Travel suppliers then target Yatra users with discounts as high as 40 percent. Value assessment software considers 50 factors (such as departure time, airline and airport) at point of sale to help travelers choose the best option.

A PDA and a Web-enabled phone are as essential on a business trip as a briefcase. But what if you need hard copy of something that's been e-mailed to you? Or if you want to print out a document you've downloaded from the Internet? A new company called **PrintMe** allows you to e-mail or upload a file from any Internet-connected device – including a BlackBerry™, wireless Palm, Handspring Treo or any two-way pager or device – to either a fax machine or a PrintMe station. (Hotels, conference facilities, airport lounges, print shops, and private companies around the world have added PrintMe stations to their locations.)

Travel technology firms **QIXO** and **Travelogia** have a new joint venture: BoardingPass, a free desktop software

program that simultaneously searches the top 28 airline sites, including Travelocity, Expedia, Orbitz and CheapTickets, plus several dozen major airline Web sites for the lowest fares, then allows customers to book air directly at their selected site. When a fare search is complete, out pops a simple list that can be sorted to compare price, flight times, airline or number of stops. The software download is free; if you book a ticket after a BoardingPass search, you pay a \$20 service fee per ticket.

Boingo Wireless lets travelers tap into Wi-Fi access points (called hot-spots) now being installed at hotels and airports around the country. Add a \$100 card to your laptop and you can connect wirelessly to the Internet, as

long as you're within about 150 feet of the hotspot. You can buy access from Boingo or its partner EarthLink by the day or month.

SideStep is an enormously popular free, low-fare travel search tool that helps you comparison shop for the Web's best travel deals. Plug in

details of a trip and the search engine combs up to 100 suppliers' real-time inventories and displays the results in a way that allows instant comparisons. If and when you're ready to buy, you can click on a link that takes you directly to the seller's site.

Looking for a Web-based corporate travel management system that's pretty much plug & play? **e-Travel, Inc.** provides online managed travel services for several major global companies (including Ingersoll-Rand and Philip Morris). With it, travelers can book air, car, hotel and rail, all within corporate guidelines.



Travelocity, one of the pioneers of Web-based travel bookings and currently the largest online travel agency (at least in terms of gross travel bookings), provides Internet and wireless reservations information for more than 700 airlines, more than 50,000 hotels and more than 50 car rental companies worldwide. New, is the firm's online concierge service, which allows Travelocity "members" (you have to enroll to use the site) to pre-book theater tickets, tee times and restaurant reservations.

Expedia, the virtual travel agency, has made a major push into corporate travel by buying Metropolitan Travel, a Seattle-based corporate travel agency. Metropolitan will provide the bricks part of a bricks-&-clicks operation; Expedia will provide the technology, including its proprietary Expert Searching and Pricing (ESP) platform; Metropolitan will provide a 24-hour corporate travel customer service center. The combination of high-tech and high-touch, says Patricia Elliott, president of Metropolitan Travel, makes for a powerful synergy. "Expedia will allow us to increase the value of services we provide both online and offline in ways we could never achieve alone," she says.

Austrian Airlines has come up with a novel (and popular) way to encourage travelers to fly the carrier to destinations beyond Austria. Fly in Austrian's award-winning Business Class, called Grand Class, and you can take advantage not only of the excellent connections the airline has to offer, but also a lavish

SideStep is an enormously popular free, low-fare travel search tool that helps you comparison shop for the Web's best travel deals.

one-night stopover, thanks to a program called Vienna On Us. Besides a complimentary night on the town in one of Vienna's top hotels, travelers are treated to private limousine service to and from the airport, and a gourmet dinner and buffet breakfast at the hotel restaurant.

Whether or not you take advantage of the Vienna On Us program, the flight will be grand, even if you have to work. Austrian Airlines Grand Class offers first-class amenities for a business class fare. Seats are equipped with a laptop connection and phone line; there's also a fax service from the Grand Class cabin. For travelers in the New York and Washington, D.C. metropolitan areas, a complimentary limousine service will whisk you from your home or office to the airport. Once in the airport, there are sumptuous lounges that double as full-fledged business facilities.



Sprint and Sanyo Introduce America's First Built-in Camera Phone

POINT, SHOOT, CLICK AND CALL: All four are possible with the brand-new PCS Phone by Sanyo 5300, America's first wireless phone with a built-in camera. Launched in November by Sprint and Sanyo, the PCS Phone by Sanyo 5300 combines the functionality of a digital camera with the clear calls of a PCS Phone. It enables Sprint wireless customers to instantly shoot, view and share photos nationwide, in addition to making crystal-clear calls on the PCS enhanced nationwide network. The 5300 has been designed to support the PCS Vision applications and services, including downloadable Java-based games, animated ringtones and screen savers. Sprint (which operates the largest all-digital, nationwide PCS network) and Sanyo will offer the PCS Phone by Sanyo 5300 to customers nationwide in November for a suggested retail price of \$399.99.

"Sanyo is proud to be the first wireless phone manufacturer to deliver a built-in camera phone to the U.S. market," said Atsushi Koderu, group vice president, general manager of Sanyo Fisher Company's Communications/Information Technology Division. "Consumers will be delighted and amazed with the SCP-5300, a phone that makes it easy to point, shoot and share a digital picture virtually anywhere and anytime. Business travelers will be especially pleased with our vivid color screen and such integrated features as Voice Activated Dialing, Voice Memo, Call Screening, a 500-number electronic Phone Book, and handy Scheduler/Calendar and To-Do List."

Portal Power

Using the Web to book travel has never been easier. B2B portals built specifically for corporate travel purchasing integrate the planning and purchasing of a trip – in other words, you can use a single site to book air, hotel, and car rental, make restaurant reservations and book tee times, get driving directions, and exchange currency. Here are a few to keep in mind.

Orbitz for Business. The airline-owned site Orbitz, known for its deep discounts on airline tickets and hotel rooms recently launched a portal called Orbitz for Business. "The response has been overwhelming, confirming Orbitz's belief that the program is providing what companies and business travelers wanted – an inexpensive and

easy-to-implement corporate travel solution," explained Rick Weber, vice president of business services. "We're currently in discussions with hundreds of companies interested in reducing travel management costs and providing their business traveler customers with more flight options and the most Web-only fares," he said.

Not only do customers save on fares, but on fees; they can save up to 75 percent on the \$40-\$60 transaction fees typically charged by most offline corporate travel agencies. Online enrollment takes a few minutes, and implementation can be complete in 48 hours. For info: www.orbitz.com/business.

GetThere, a subsidiary of travel reservations giant Sabre, uses secure, high-speed connections to link a

Point, Shoot and Share Picture Mail

Personalization Like Never Before!

It's the PicturePhone by SANYO, the SCP-5300 with a built-in VGA digital camera – and it's exclusively available from Sprint. Point, shoot and share a digital picture virtually anytime, anywhere on the enhanced Sprint Nationwide PCS Network and with PCS VisionSM from Sprint, you'll get clarity you can see and hear.

- Easy to use built-in digital camera with flash and digital zoom
- The fun of taking and sharing quality resolution images
- One of the best color screens available today
- The advantage of instantly viewable thumbnail images
- Improved Web browser
- Animated icon driven menu for ease of use

In the first year of the study conducted by J.D. Power and Associates, Sanyo ranked "Highest in Customer Satisfaction With Wireless Mobile Phones."

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corporate Intranet or a Web site to GetThere's online booking and travel management data centers. GetThere manages all of the hardware, software, system upgrades, security, reliability, availability and system growth; it's designed to be a kind of plug-and-play service, only without a large capital outlay for hardware and software. It's also easy to use. Employees log onto their corporate Intranet site, and click on the travel icon. From there, it's a few clicks to booking airline, hotel and car. Users also can check prices and availability, compare routes, and make changes to itineraries as well.

Navigant's Custom Travel Portals also can transform a simple corporate Web site into a travel management tool. Using secure encryption, a company's proprietary policies and vendor programs are automatically passed along at point of travel purchase. Navigant's standard travel portal includes an information center with links to often-used sites (MapQuest.com™, City Search.com, Weather.com, etc.), and a traveler profile section (with airline seat, rental car and hotel room preferences, plus frequency program numbers) that can be maintained online, electronic travel request form, links to current itineraries, passport and visa information, and a three-month pop-up calendar to assist in making travel arrangements. Customized options include, but are not limited to: actual online booking, reports on T&E spending, and meeting registration.



The American Express "superhub" portal lets travelers research, book and buy T&E from a single, easy-to-use Web location. Current material about destinations, theater, sporting events, concerts, films and restaurants around the world are included along with a way to quickly and easily book airline tickets, hotel rooms and rental cars. Information partners include Fodor's, Zagat Survey, Travel & Leisure, MapQuest, Playbill, Ticketmaster, citysearch.com and MovieFone.

Unlike most other travel sites and most other B2B travel portals, americanexpress.com/travel is backed offline by a team of experienced travel counselors. Visitors to the site can e-mail or call an Amex travel specialist with expertise on specific destinations, for example; while on the road, travelers can tap into the company's network of 1,700 travel and foreign exchange services in 130 countries.

Correction: The quickest way to the Citibank AAdvantage MasterCard Web site is: www.citibank.com/aadvantage

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A TOPSY-TURVY INFO TECH 100

Some of last year's losers are back on top—as a few Internet and telecom stars emerge from the rubble

It looks like a spoonful of alphabet soup sitting at the top of the list. CACI International Inc. and GTSI rank first and third, respectively, in *BusinessWeek's* Info Tech 100, ahead of such powerhouses as Microsoft Corp. and Dell Computer Co. These little-known companies are making money, lots of it, prepping America for war.

CACI, in Arlington, Va., runs computer systems for the Pentagon and the Federal Aviation Administration (box, right). In just the past two quarters, it has raked in \$1.1 billion in new government contracts. GTSI, in Chantilly, Va., which sells 93% of its computers and software to the federal government, boosted its net profits 56%, to \$3.1 million, in the third quarter.

And expect the rich to get richer: The \$52 billion federal tech budget, which rose 10% this year, could grow faster next year as the new Homeland Security Dept. takes shape. "The U.S. is at war," says GTSI CEO Dendy Young. "There's a heightened level of urgency."

Say "Boom!" today, and investors hear the explosions from heat-seeking missiles. It's quite a change from the dot-com days. But strip away government contractors, and the familiar names in the IT 100, from phone giant Nokia Corp to dot-com auction champ eBay Inc., are settling into patterns that point to important trends in technology.

Two themes emerge in this midyear check on *BusinessWeek's* best-performing

tech companies. First, in the industries most savaged by the downturn—the Internet and telecom—sturdy champions are emerging from the rubble. From travel site Expedia Inc. to Spain's Telefónica Móviles, these rising stars have growing clout in their industries, make real profits, and throw off lots of cash. The other trend, far less surprising, is that in the current tech slump, industry behemoths rule their roosts. That's why Dell, Nokia, IBM, and Microsoft represent safe havens in today's storm.

Each June, our survey ranks the world's best 100 information technology companies by their revenues, sales growth, profitability, and stock appreciation. In the fall, we tally share performance during the previous six months. Following a punishing stock market ride, each of our eight sectors declined, and the whole list dropped 16.2%.

In this sinking market, Internet companies on the list fared better than the others, dropping only 4.4%. They're winning with old-fashioned growth and profits. Two of the brightest stars are in travel. No. 26

Hotels.com is projected to boost sales 85% in 2002, to \$992 million, and to rack up operating earnings of \$80.6 million, a five-fold increase from last year, says Legg Mason Wood Walker Inc. analyst Thomas S. Under-



AHEAD OF THE PACK

The top performers in eight sectors:

SECTOR	COMMUNICATIONS EQUIPMENT	COMPUTERS & PERIPHERALS	DISTRIBUTORS	INTERNET CO.'s	SEMICONDUCTORS
	-17.3%	-17.7%	-11.1%	-4.4%	-30.3%
TOP PERFORMER	KDDI	SYNNEX	GTSI	EBAY	HOYA
	+7.4%	+30.8%	+31.1%	+19.1%	-11.7%

wood. He also expects strong results for Expedia (No. 53), which is on track to hike its annual revenues by 98% and more than double profits. And both companies are expanding fast: Hotels.com's sales are booming overseas, while Expedia is eyeing the corporate market.

The biggest dot-com star remains eBay. It's a natural winner in a down market: Hard-pressed users raise cash by selling baseball cards and old trumpets. And it has become a familiar rite for companies gone belly-up to unload their PCs and Cisco routers on eBay. Feeding this boom is a growing online population—and a growing trust in online transactions. eBay's online marketplace now numbers 24.2 million active

users, up from 13.2 million at the start of 2001. Gross sales per user have risen 14.6%, to \$511. Next year, analysts expect revenues to rise 55%, to \$1.8 billion, with net income climbing 49%, to \$330 million. "Our dream of becoming the commerce engine of the Internet is coming true," says Chief Executive Margaret C. Whitman.

In Europe, telecom players are on the comeback. The group of 27 on our list declined a mere 8.4% since April, not bad compared with the 21.1% plunge the NASDAQ took. The best performers: Europe's fast-growing, cash-churning mobile-phone powers, which took 6 of the top 15 spots. Why the surge? Investors fled the sector two years ago, when telcos plunged into debt to buy the next generation mobile networks, known as Third

Generation (3G). Many of these companies have worked down their debt, postponed 3G investments—and are raking in cash.

Among the brightest stars is Britain's mm02 PLC, spun off from BT Group PLC last year. In the fiscal year ending Mar. 31, revenues are expected to grow 4% while spinning out a solid \$925 million in operating cash flow, predicts Mark D. James, an analyst at Nomura Securities International Inc. in London. But for mm02 and other mobile players, there's a catch. Earnings will dip as investment in 3G ratchets up. Future growth hinges on growth in mobile data, an unproven market.

The picture is far clearer for the tech titans on the list. Dell increased its global market share in PCs from 14.8% to 16% in the third quarter to retake the lead from Hewlett-Packard Co. (No. 35), according to market researcher IDC. Now, it's targeting HP's cushy po-

sitions in printers and personal digital assistants. And smaller-fry tech players? Forget about them, says Barry Jaruzelski of consultancy Booz Allen Hamilton Inc: "Are you going to risk key pieces of your infrastructure to a company that may not be around?" Such are the grim calculations that separate winners from losers in today's chilly tech market.

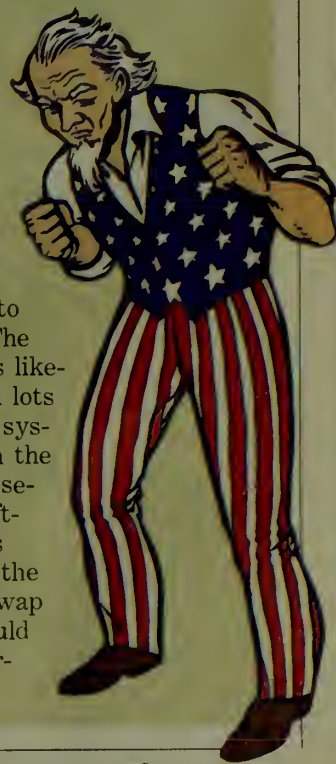
By Andrew Park in Dallas, with Andy Reinhardt in Paris

BusinessWeek online

To read more about top IT 100 performers, including Oracle and GTSI, go to the Nov. 25 issue online at www.businessweek.com

OUT IN FRONT

Call it the new military-industrial complex. With operating earnings at traditional defense giants like Lockheed Martin Corp. and Boeing Co. flat or down, tech companies such as CACI International Inc. are emerging as the new wave of businesses to profit from Pentagon contracts. In the past two quarters, CACI has won government contracts totaling \$1.1 billion for everything from managing communications networks for the U.S. military to handling classified programs for the intelligence agencies. Overall, 91% of the company's revenues come from the Feds. That has pushed the stock up 36%, sending CACI to the top of the IT 100 list. In the third quarter, sales rose 29%, to \$188 million, while net income jumped 39%, to \$9.4 million. The government is likely to invest in lots more defense systems. High on the list: database security and software that lets computers at the FBI and CIA swap data. That could mean more orders for CACI.



SERVICES	SOFTWARE	TELECOM
5.7%	-17.3%	-8.4%
CACI	INTUIT	VIMPELCOM
15.6%	+32.5%	+19.0%

Information Technology

HOW THE IT 100 HAVE FARED[†]

RANK	COMPANY NAME	6 MONTHS* TOTAL RETURN	12 MONTHS* TOTAL RETURN	JUNE RANK	RANK	COMPANY NAME	6 MONTHS* TOTAL RETURN	12 MONTHS* TOTAL RETURN	JUNE RANK
1	CACI International	35.6	31.5	70	51	CSK	-15.8	-2.0	20
2	Intuit	32.5	29.1	48	52	Automatic Data Processing	-15.8	-16.9	12
3	GTSI	31.1	68.1	60	53	Expedia	-16.3	148.2	87
4	Synnex Technology Intl.	30.8	106.5	67		S&P 500 Index	-16.9	-14.9	
5	eBay	19.1	20.5	83	54	Reynolds & Reynolds	-17.6	1.3	49
6	VimpelCom	19.0	42.4	40	55	Gigabyte Technology	-18.5	18.6	61
7	mm02	18.1	NA	89	56	Overture Services	-19.5	4.5	73
8	Infosys Technologies	15.8	52.2	71	57	Inventec	-20.1	51.6	68
9	Telefónica Móviles	14.6	6.7	34		Nasdaq Composite Index	-21.1	-20.9	
10	Tele2	12.0	-25.3	91	58	KT Freetel	-21.5	-13.4	4
11	Electronic Arts	10.3	26.5	44	59	AT&T Wireless Services	-23.2	-52.4	76
12	Dell Computer	8.6	19.3	5	60	TDC	-25.5	-35.2	84
13	KDDI	7.4	12.0	45	61	SunGard Data Systems	-25.5	-12.0	36
14	Mobile Telesystems	4.4	16.1	19	62	China Mobile (Hong Kong)	-26.2	-19.5	6
15	Telecom Italia	3.2	0.4	57	63	Global Payments	-26.3	-5.2	59
16	CenturyTel	2.7	-9.7	38	64	L-3 Comm. Holdings	-26.4	8.2	10
17	Microsoft	2.3	-8.0	27	65	Harris	-26.9	-22.5	79
18	Nokia	2.2	-18.0	54	66	América Móvil	-27.7	-9.9	66
19	Alltel	2.0	-10.6	30	67	Computer Sciences	-28.0	-10.1	28
20	Oracle	1.5	-24.9	53	68	Quanta Computer	-28.7	12.8	2
21	BCE	1.4	-18.3	64	69	BenQ	-28.8	96.5	13
22	Compal Electronic	0.9	71.0	65	70	Logitech International	-29.0	7.3	14
23	Telstra	0.4	11.5	18	71	LG TeleCom	-29.0	1.8	43
24	Lexmark International	-0.6	32.8	16	72	Fiserv	-29.7	-16.0	29
25	Vodafone Group	-0.8	-30.2	55	73	UTStarcom	-30.3	-27.3	90
26	Hotels.com	-0.9	101.4	86	74	NTT DoCoMo	-30.5	-31.7	62
27	CDW Computer Centers	-3.2	15.1	17	75	Alliance Data Systems	-31.0	6.3	94
28	Ingram Micro	-3.6	12.0	75	76	Tech Data	-32.5	-25.2	37
29	Telenor	-3.6	-1.8	15	77	Apple Computer	-33.8	-8.5	52
30	Verizon Communications	-3.8	-21.1	72	78	Nintendo	-34.1	-36.9	47
31	Hon Hai Precision Ind.	-4.0	14.0	3	79	Activision	-34.9	-14.9	41
32	Canon	-5.1	26.3	24	80	NTT Data	-35.3	-30.6	88
33	IBM	-5.4	-26.5	21	81	China Unicom	-36.5	-31.5	80
34	SK Telecom	-6.2	-4.5	9	82	Accton Technology	-37.3	18.7	46
35	Hewlett-Packard	-6.5	-4.2	99	83	DST Systems	-37.8	-24.9	39
36	Wavecom	-7.2	14.8	51	84	D-Link	-38.2	13.7	100
37	Samsung Electronics	-9.6	100.2	1	85	Elitegroup Computer Sys.	-38.3	3.1	8
38	Scansource	-10.4	40.0	35	86	Intel	-39.4	-28.9	56
39	Deutsche Telekom	-11.3	-24.3	74	87	KLA-Tencor	-39.6	-12.8	82
40	Kronos	-11.7	-6.2	63	88	Motorola	-40.1	-43.3	95
41	Hoya	-11.7	15.7	85	89	Asustek Computer	-40.2	-36.4	23
42	First Data	-12.0	3.6	50	90	SAP	-41.0	-25.1	31
43	BellSouth	-12.5	-27.5	42	91	Sharp	-41.8	-17.8	92
44	IDT	-14.0	55.7	96	92	Certegy	-45.9	-26.3	26
45	Storage Technology	-14.1	-5.8	81	93	Dassault Systèmes	-46.6	-38.6	97
46	Groupe CGI	-14.5	-30.0	58	94	BISYS Group	-47.7	-31.2	33
	Dow Jones Industrial Average	-14.6	-5.4		95	Cadence Design Systems	-50.5	-52.1	93
47	Affiliated Computer Services	-14.8	4.6	7	96	Concord EFS	-56.2	-47.8	22
48	Wipro	-14.9	28.3	98	97	Itochu Techno-Science	-59.2	-75.4	69
49	Japan Telecom	-15.2	-15.8	77	98	Cap Gemini	-61.7	-59.9	78
50	SBC Communications	-15.7	-30.2	25	99	Electronic Data Systems	-72.1	-76.3	11

* Through Oct. 31 † Software Spectrum was acquired

Data: Standard & Poor's, Bloomberg

The Better Online CRM Solution

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salesforce.com 34%

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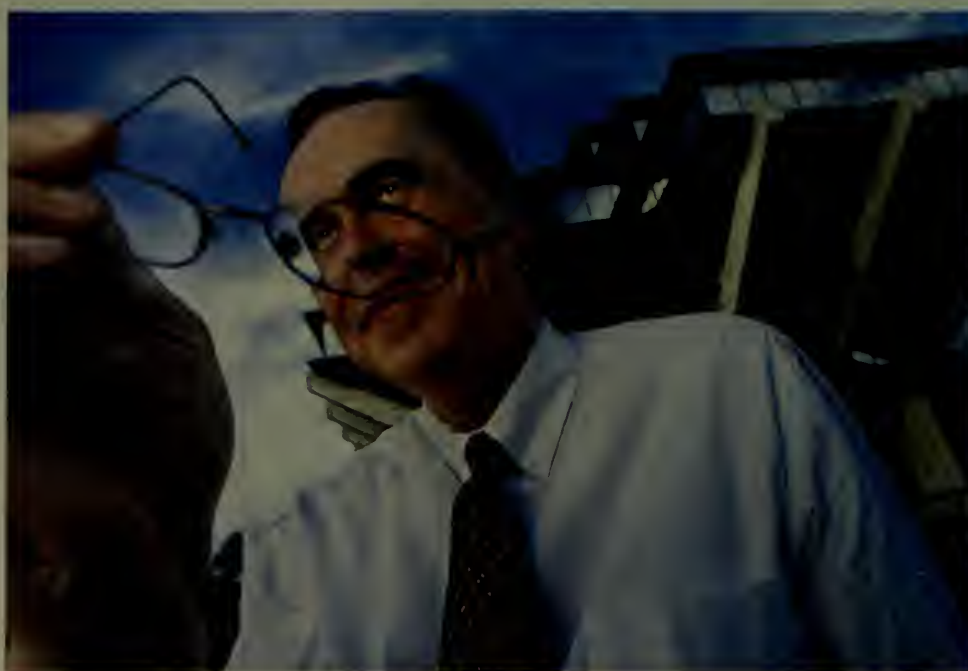
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EDUCATION

A NEW BLUEPRINT FOR B-SCHOOLS?

UC-San Diego has a risky plan for a tech-savvy, fast-track MBA



SULLIVAN: A chance to "put into practice what we're telling others to do"

How do you build a new business school in a market flooded with MBAs? First, start with a hot research university, throw in a B-school veteran to take the reins, and drum up the support of the biggest companies nearby. Make it interesting by junking the conventional business-school model, and you just might have a fighting chance.

That's the blueprint the University of California at San Diego intends to use when it enrolls its first MBA class in the fall of 2004. UCSD envisions a short, tech-focused MBA program with strong ties to its well-regarded medical and engineering schools. The B-school has already wooed Robert S. Sullivan, dean of the University of North Carolina at Chapel Hill's Kenan-Flagler Business School, to head it up. And the administration

is giving him the freedom to innovate in a way entrenched B-school deans only dream about. "Business schools have never put into practice what we're telling others to do," contends Sullivan. Now, he's relishing the chance to lead by example.

For UCSD, that means that everything from introductory courses to lecture halls to traditional semesters could be tossed. In their place, MBAs will proba-

bly get a broadly integrated curriculum delivered in a one-year program—vs. the traditional two—that rounds out science skills with management knowhow. Only Young Turks with tech savvy need apply: UCSD aims to recruit two-thirds of its students from science and technology backgrounds, and the admissions staff will target applicants around the age of 24—not 27 or 28, as traditional B-schools do. Students who, say, don't already know statistics will take a UCSD course on their own over the Internet rather than waste class time on the basics. And classes will be supplemented with hands-on work in businesses such as local biotech Biosite Inc.

The science focus makes sense: Even as hiring in financial services and consulting continues to evaporate, biotechnology and pharmaceutical companies have nearly doubled their MBA recruits. Sullivan has studied Massachusetts Institute of Technology's Sloan School of Management, which is heavily influenced by the school's engineering eminence and Canada's Queen's University, whose tech-focused MBA shot to No. 2 in *BusinessWeek's* 2002 non-U.S. rankings. Sullivan will have some local competition—across town, San Diego State University's new B-school dean, Gail K. Naughton, is a biotech entrepreneur—but Sullivan is banking on UCSD's stellar reputation and community influence. More than 160 nearby companies have sprouted from UCSD research.

UCSD won't be the first school to try something different, but observers say it's the most ambitious attempt in decades to reinvent management education. That has excited the San Diego business community, a tech-heavy lot that could be well-served by UCSD's focus. Companies such as Qualcomm Inc. and Sempra Energy Solutions will provide financial support—and a pool of prospective students. Qualcomm CEO Ir-

win M. Jacobs, who taught computer science and engineering at UCSD from 1966 to 1972, says he anticipates turning promising engineers into managers through executive-training programs at the B-school. Local business leaders hope the new school can spur a maturing San Diego economy. "There are many startups here that have failed," says Malin Burnham, chairman of Burnham Real Estate

STARTING FROM SCRATCH

Robert Sullivan is building a brand new B-school at the University of California at San Diego. Here's what he plans to do differently:

OLD WAY

- Recruit students with about four years' work experience
- Offer specialized training in functional areas
- Teach traditional classes on campus
- Divide two-year program into semesters and quarters

NEW WAY

- Lure bright students with little to no work experience
- Cross-discipline curriculum, linked with other schools
- Include hands-on immersion and self-directed course work
- Deliver course work in custom modules over one year

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Services and a former chairman of the UCSD Foundation. "But what if they had had better management training to go with their technical training?"

To get the ball rolling, Sullivan plans to hire 10 faculty members in the coming year. His eventual target is 65 full-time faculty, augmented with 30 adjuncts and professors from other UCSD departments such as medicine, engineering, and psychology. Although the five-year plan calls for a full-time MBA class of 300, Sullivan will open his doors at first to about 100 part-timers sponsored by their employers. The school will need the cash: Like UC-Berkeley and UCLA, UCSD will charge tuition of about \$22,700 a year for part-timers. Sullivan won't have as much leeway with full-time students; state rules force University of California B-schools to charge in-state full-time MBA students only about \$11,000 a year. That's one-third of the cost of a top private B-school.

Sullivan, 58, has never been afraid to shake things up, even at the most staid B-schools. As dean of Carnegie Mellon University's B-school in the early 1990s, Sullivan soothed overlooked students rankled by a mishandled expansion and redirected a powerful political economy department toward more practical coursework. "It was a mess when he got there, and he turned it all around," says Douglas M. Dunn, now retired, who succeeded Sullivan at Carnegie. Sullivan—who spurned a choice post-MBA job at DuPont in 1968 for a Peace Corps stint in Ethiopia—hopes to exploit San Diego's location to foster ties with Latin America and Asia. That's right up his alley: At UNC, he spearheaded the ambitious One MBA, an executive program delivered by five B-schools on four continents.

Sullivan may be thinking globally, but he'll be rooted in the local, particularly as part of the UC system. That means curriculum changes and faculty hirings will have to be approved by each of the other UC B-schools. "The overcentralization naturally makes things more conservative," warns UC-Irvine's B-school dean, Jone L. Pearce, and could frustrate Sullivan's entrepreneurial impulses. Critical will be the political ability of Sullivan's key staff to work the system.

Sullivan realizes he's locked in the state's fiscal handcuffs but says he'll hit up local execs for seed money in the short term. He's not promising venture capitalists any returns. "Some [ideas] aren't going to work, but shouldn't we try them?" asks Sullivan. Fast-growing San Diego could make a good incubator for Sullivan's big ideas. Successful or not, this startup could become a case study for B-school deans everywhere.

By Brian Hindo in New York

People

CONSULTANTS

REBUILDING TRUST IN TYCO

Wharton's Mike Useem aims to overhaul the corporate culture. But was he too close to the problem?



AT GETTYSBURG: *Providing students with a field guide to leadership*

In 1992, Michael Useem traveled to Tyco International Ltd. headquarters in Exeter, N.H., to interview L. Dennis Kozlowski for a book. The modest, two-story wooden building, the microscopic headquarters staff, even the stock ticker on the receptionist's desk all impressed the Wharton School professor as signs of a hyper-lean organization bent on increasing shareholder value. The tiny coffee room Kozlowski chose for the interviews seemed to speak volumes about his management style and philosophy, as did his tale about a search for a results-oriented division president. Useem was so impressed that he later would lavish praise on the company and its brash new CEO, describing him as a "superstar" and a "miracle maker." Useem also participated in a boot camp for neophyte CEOs

organized by Kozlowski. He never foresaw the trouble that would follow. Says Useem: "I took character and integrity for granted."

A decade later, Kozlowski's sprawling empire has imploded. Useem, meanwhile, has been handed the task of helping Kozlowski's successor rebuild trust in the company and safeguarding against a repeat of one of the most spectacular governance failures in history. It's a job not everyone agrees he's cut out for. Says Barbara Ley Toffler, adjunct professor of management at Columbia University: "Major corporate figures like Kozlowski seem to attract pet academics who become cheerleaders for them. I think they become blind to the flaws. I suspect that's what Mike Useem did with Kozlowski." But Useem him-



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self, along with some governance experts, says his failure to predict Kozlowski's downfall makes him eminently qualified. Who better to put governance safeguards in place than a man who knows firsthand how scoundrels can masquerade as saints?

Wise or not, in choosing Useem, 60, for its governance overhaul, Tyco has opted for one of the field's most unconventional thinkers. In his leadership classes at Wharton and his 1998 book *The Leadership Moment*, Useem draws inspiration from historical figures who have faced extreme challenges. His executive MBA students learn how leaders react under pressure by visiting scenes of triumph and disaster—including a deadly 1996 Everest summit attempt.

Unlike many of his contemporaries, Useem views governance as a function of leadership and corporate culture, not an exercise in the rote application of rules. He says many standard reforms that boards implement—gathering independent directors without management present, separating the roles of CEO and chairman, and ensuring board independence—have benefits that are at best ambiguous. He's more likely to craft an innovative approach to Tyco's problems that goes beyond the rules-based overhauls put in place at Walt Disney Co., Computer Associates International Inc., and other companies after their boards came under fire. "You won't see cosmetic change," says Arthur O. Sulzberger Jr., chairman and publisher of the New York Times Co., a Useem consulting client. "If there's a need for a culture shift, he's got all of the skills necessary to engage in that."

Tyco also chose someone who, to some extent, will be learning on the job. While Useem has advised many companies, this is the first time he's been asked to participate in a governance overhaul. The job couldn't be bigger. Tyco CEO Edward D. Breen hired Useem within 10 days of his own arrival. Just weeks later, Kozlowski and former CFO Mark Swartz were accused of looting the company of \$170 million and reaping another \$430 million from

stock sales. An internal investigation would reveal that three directors had lucrative, undisclosed business ties to the company. Since then, all nine Kozlowski-era directors have indicated they would resign, although two will be chosen to stay as consultants. "Tyco really needs to go from worst to first," says Useem. "It really does have to transform itself."

Transformation is something Useem

ness. From their camps high in the Himalayas, his students analyze the management mistakes that led to the death of eight climbers on Everest. In Colorado, they hike the hillside where 14 firefighters lost their lives in a fast-moving 1994 blaze, examining leadership blunders that contributed to the disaster. And at Gettysburg, they visit Little Round Top, where a Union bayonet charge—led by Joshua L. Chamberlain

like Useem a professor in civilian life—proved crucial to the Civil War's outcome.

Useem says that students develop a visceral understanding of the problems leaders encounter. "He goes out on his way to make everything a learning experience," says Valerie Breuninger, a student who was on the 2002 Himalayas trek.

On governance matters, Useem is an iconoclast, having staked out positions that set him at odds with many peers. While Tyco will need to implement conventional reforms, Useem says they will not solve the company's biggest problem. Under Kozlowski, he says, Tyco's culture discouraged subordinates from questioning top executives and discouraged contact between directors and second-tier managers. To restore checks and balances, Useem

advocates weaving ethics into the fabric of the company. He suggests focusing as much on integrity as business acumen when recruiting directors and making rigorous compliance with ethical standards a condition for promotion.

It's not enough, he says, to tell midlevel managers they have a duty to report superiors they suspect of fraud. Tyco needs an ombudsman for whom bringing problems to the board is a "sacred obligation." Says Useem: "You have to have in place devices to guard against the evil that lurks within."

Still, is Useem the best person to set up such a system? There's no way to tell yet how effective he will be, since Tyco is still mulling over his suggestions. But this is one battlefield where the professor is intimately familiar with the terrain—and has an incentive to ensure that this time the good guys come out on top.

By Louis Lavelle in New York

MICHAEL USEEM

BORN

Nov. 6, 1942, Vermillion, S.D.

EDUCATION

BS, physics, University of Michigan, 1964; MA, physics, Harvard University, 1966; PhD, sociology, Harvard University, 1970



CURRENT JOB

Adviser to Tyco; professor of management, the Wharton School, University of Pennsylvania

WHY TYCO HIRED HIM

Unconventional thinker whose main area of research is corporate leadership



GREATEST ACHIEVEMENT

Scaling Cotopaxi, a 19,348-foot volcano in Ecuadorian Andes

MOMENT OF TRUTH

When he received his first grade of B as an undergraduate, his mother sent him a telegram: "Welcome to the human race"

FAMILY

Married to Elizabeth, a researcher for a Philadelphia nonprofit organization; three grown children: Jerry, 31, Andrea, 29, and Susan, 19

knows well. Growing up the son of college professors in East Lansing, Mich., Useem lived a middle-class life. In the 1960s, he became active in the antiwar movement at Harvard University, where a student deferment allowed him to avoid the draft. His outlook changed during that turbulent decade: Abandoning a promising future in physics, he chose to focus on more flesh-and-blood problems through a PhD in sociology, his parents' discipline. "At Cambridge, we thought the revolution was around the corner," says Joel Lamstein, a close friend. What followed was a distinguished academic career that included stints at Harvard and Massachusetts Institute of Technology before Useem moved to Wharton in 1990.

For years, he has taught courses that could be called a field guide to leadership—an approach critics say is "almost useless" for instructing students in the everyday demands of running a busi-

PLATTS/BUSINESSWEEK

GLOBAL ENERGY AWARDS 2002

The Platts/BusinessWeek Global Energy Awards has become the most prestigious awards program in the industry. Drawn from nearly every continent, this year's finalists illustrate the industry's innovative spirit and enduring commitment to customers, shareholders, and future generations.

There will be a gala event at The Plaza Hotel in New York on November 18, 2002 to announce the winners in the following categories:

- Energy Company of the Year
- CEO of the Year
- Power Company of the Year
- Coal Company of the Year
- Gas Company of the Year
- Oil Company of the Year
- Energy Engineering Project of the Year
- Most Successful Strategy Shift of the Year
- Renewables Company of the Year
- Strategic Merger of the Year
- Community Development Program of the Year
- Most Innovative Commercial Technology of the Year
- Most Promising Pre-Commercial Technology Development

Meet Some of the Finalists ▶

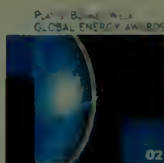
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ENEL

Italy's Enel Finalist in Two Categories

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● Paolo Scaroni, CEO of Enel

ENEL SPA, ITALY'S LEADING ELECTRICITY COMPANY and the fourth largest in Europe, is a finalist in two categories of the 2002 Global Energy Awards. Wholly-owned unit Enel GreenPower was shortlisted for Renewables Company of the Year and Enel's trailer-mounted HV/MV substation was voted one of the best pre-commercial technologies. This is not only a significant achievement in itself but further validates Enel's new strategy: "focus on the things you do best and do them better than everyone else".

Paolo Scaroni became Enel's Chief Executive in May 2002. He has since implemented an internal reorganization and set out new strategic guidelines, refocusing the group on its core electricity and gas business while halting diversification.

In Italy, amid growing competition, the goal is to become the lowest cost generator by shifting the fuel mix away from oil towards cheaper fuels and combined cycle gas. Seventy-five percent of generation will be hydro, coal, orimulsion and combined cycle gas by 2007.

While international expansion in core activities has not been ruled out, it is considered only one of the possible uses for the Group's cash flow. Scaroni has set no expansion targets and has clarified what he considers to be acceptable conditions: "all acquisitions must be justified on a stand-alone basis".

Geographically, the priorities are Iberia and European countries offering cross-border power transfers. The countries of Central and Eastern Europe - where Enel can apply its experience in transforming state monopolies into competitive suppliers of choice - are also attractive.

In renewables, Enel wants to consolidate its position as a world leader and will look for development and acquisition opportunities worldwide.

With more than 2,500 MW of installed capacity in Italy, North America and Latin America, Enel

GreenPower produces over 9 billion kWh/yr of electricity from renewable sources - enough to spare 1,800,000 tons of oil consumption. In addition, the mix of sources is unique: 1,800 MW of hydroelectric capacity, 600 MW of geothermal, 131 MW of wind, 25 MW of biomass and biogas, and 4 MW of photovoltaic.

Enel's other finalist - the HV/MV substation - is as much a technical and environmental leader as it is a cost cutter. It costs around 70% less than a traditional substation and occupies one third of the space. The new station, together with remote operation of the medium voltage network, represents a significant step in the creation of a new, more efficient distribution network model.

These nominations are further acknowledgement that Enel represents an international benchmark in environmental performance and technical leadership. ●

Focus on the things you do best and do them better than everyone else.

Enel Strategy

FINALIST Renewables Company of the Year
Most Promising Pre-commercial Technology of the Year



ENTERGY CORPORATION

For Entergy, a Stellar Year

Back-to-Basics Strategy, Nuclear Expansion Are Keys

CHIEF EXECUTIVE OFFICER J. WAYNE LEONARD HAS steered the Entergy Corporation through a stellar year of financial and operational performance. The New Orleans-based integrated energy company emphasized a back-to-basics strategy, aggressively pursuing business based on its core capabilities: electric utility operations for 2.6 million customers, a growing nuclear generation portfolio and wholesale energy services.

Entergy's risk management approach emphasizes the company's strengths while constantly monitoring and adapting to changing conditions. From mid-1998, when Wayne Leonard joined the company, through September 2002, Entergy's stock price appreciated 73 percent. By comparison, the Standard & Poor's Electric Index of companies declined 16 percent during the same period. In addition, Entergy's annual earnings growth since mid-1998 has averaged 16 percent.

Entergy in the 1999-2002 period doubled its nuclear fleet to 10 plants, making it the second largest U. S. nuclear generator. That fleet operated at a 96 percent average capacity factor in 2001, setting five world, national or site refueling outage records. The company's nuclear growth strategy worked so successfully that Entergy earned the 2002 Edison Award from the Edison Electric Institute, the electricity industry's highest honor.

Another Entergy success story this past year is Entergy-Koch, LP – Entergy's partnership with Koch Energy Inc. – which transports, markets and trades natural gas, power, weather derivatives and other energy-related products. Offering a broad range of energy commodity risk management tools, Entergy-Koch has used its extensive knowledge and market analysis to benefit customers while achieving consistent profitability.



J. Wayne Leonard, CEO
of Entergy Corporation



● **VERMONT'S CLEANEST POWER**—The Vermont Yankee Nuclear Plant, located on the west bank of the Connecticut River near Brattleboro, Vt., produces about 30 percent of the power used in the state of Vermont without emitting any air pollutants. The plant in 2002 became the 10th nuclear plant in Entergy's fleet, making the company the largest nuclear operator in the Northeast and the second largest in the U.S.

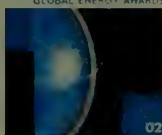
The third-largest U.S. power producer, Entergy is the only utility in the nation to be awarded membership in the prestigious Partnership for Climate Action. The company is committed to limiting its greenhouse gas production to a cap already near the bottom of the industry. Entergy has completed or initiated 33 internal emission-reduction projects with 12 external emission-offsetting projects in progress. Entergy also has been selected for listing on the Dow Jones Sustainability Index, which recognizes companies that not only demonstrate strong financial performance, but also show outstanding leadership in environmental and social commitment.

As CEO, Leonard also has championed issues such as corporate responsibility and low-income assistance. Entergy has hosted three low-income summits – and planned two others for the future – to address the problems of its disadvantaged customers. In recognition of these efforts, the National Fuel Funds Network presented Leonard with its 2002 Sister Pat Kelley Achievement Award for his efforts on behalf of low-income families. ●

FINALIST

Energy Company of the Year • Power Company of the Year
CEO of the Year • Community Development Program of the Year
Most Successful Strategy Shift of the Year





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Masada's CES OxyNol™ process is the result of a public-private effort with its research and development partners that include the United States Department of Energy, the National Renewable Energy Laboratory and Tennessee Valley Authority. Private sector team members include JPMorganChase, Kvaerner Process, Hartford Steam Boiler Inspection and Insurance, Harris Group and R.W. Beck.

Masada OxyNol™ facilities each have the capacity to process at least 200,000 tons of garbage into over ten million gallons of

ethanol each year. Participating cities have selected Masada's CES OxyNol™ process as a non-incineration alternative that achieves a 90% waste diversion, reducing the need for environmentally hazardous and costly landfills.

Masada has a history of building companies centered on emerging social needs involving technology and infrastructure. For over twenty years Masada's worldwide operations have included affiliates in telecommunications and environmental services, creating more than \$1 billion in business assets in the



Daryl E. Harms, CEO
of Masada OxyNol™

United States and Europe. Currently, Masada is focused on building a global company for environmentally sustainable, municipal wastes disposal and clean, renewable fuel production. Existing waste disposal methods increase risks to air and water quality, while Masada's environmentally safe CES OxyNol™ process re-

duces future health and environmental liabilities associated with landfilling and incineration by recycling or beneficially using over 90% of municipal wastes. Masada has developed an innovative, competitive way for renewable, clean fuel development within a framework of value and environmental responsibility. ●

FINALIST Most Innovative Commercial Technology of the Year



PARENTING

MOMMY IS REALLY HOME FROM WORK

More female high achievers are "stopping out" to raise kids—and avoiding Corporate America when they return

The Gang of Nine is a group of female friends, overachievers all, who went to Harvard Business School together in the late 1980s. After graduation, they took some of the most lusted-after jobs in New York City—at Morgan Stanley, American Express, Salomon Smith Barney, and other A-list employers. It was during this heady period in the early 1990s that

they vowed to meet at least once a month to form a kind of working-women's salon. Ever the managers, they organized their soirees by theme: the principles of feng shui, ace moves in poker, maximizing one's potential. Once, they hauled in a sex therapist—their most riotous evening on record. But as they began having children and leaving the city in the mid-'90s, their monthly rendezvous tapered off to the occasional e-mail or phone call.

Then, last April, one Gang of Niner managed to organize a reunion of seven of the original pack at Sarabeth's Kitchen on Manhattan's Upper East Side. As the group gathered for brunch,

a marked difference became clear: All but one had left Corporate America. Member Melissa James was on maternity leave, agonizing over whether to return to her job as a managing director at Morgan Stanley. (She did, but on a reduced schedule.) The rest, at least for a time, had put "former" in front of their once-triumphant titles so they could make their kids their first priority. Says Gang of Niner Cynthia Russell: "These are women you never thought would stop working."

They are hardly the only ones. A recent study by Harvard B-school professor Myra Hart found that of the women graduates from the classes of 1981, 1986, and 1991, only 38% were still working full time. The B-school's alumni bulletin summed it up with an illustration of a briefcase-toting executive rushing out of her office. The sign on the door read: "Back in Five Minutes," with "Minutes" crossed out and replaced with "Years?"

Something similar is happening at Stanford University's Graduate School of Business, where MBA program director Sharon Hoffman says the ranks of the

MBAs' NEW CAREER: ALPHA MOM

These Harvard B-school grads gathered for a reunion brunch in April. In the '90s, most were executive warriors. Now, many are no longer working. The demands of their children, they said, made it impossible.



■ **MELISSA JAMES, 38**

Managing director, Morgan Stanley
Kids: 3, 10 mos.

Working reduced schedule

■ **JANET NEZHAD BAND, 41**

Former senior counsel, MTV Networks
Kids: 8, 6

At home since 1997

■ **AMY GOLDEN, 40**

Fmr. exec. dir., broadband marketing, AOL. Sabbatical, '00-'01
Kids: 3, 3 mos.

On maternity leave till Dec.

■ **JAMIE COLUMBUS, 39**

Sold real estate company in 2000
Kids: 3, 18 mos.

At home; works as agent part-time

■ **BONNIE HUT, 39**

Fmr. sr. v-p, Capital Guardian Trust
Kids: 5, 3

At home since 1999; takes occasional projects

■ **MARGARET CHUNG CALVET, 41**

Two sabbaticals since 1997
Kids: 10, 8, 5, 2 mos.

CFO, husband's wine company

■ **CYNTHIA RUSSELL, 41**

Phased herself out of the mail-order catalog business she founded
Kids: 10, 8, 6

At home since 1996

stay-at-homes have swollen so much that she invented a term for them: stopouts. "Women are realizing it's impossible for a human being to have it all," says Hoffman. "You can have it sequentially but not concurrently."

Forty years ago, when Betty Friedan decried the subjugation of the suburban housewife, women were fighting to get out of the house. Now, some of the women who benefited most from those earlier struggles are deciding that's where they want to be.

Caught between their executive and maternal instincts, these high-achieving boomer and Gen X moms are going workforce AWOL by taking career sabbaticals that last at least a year. "I thought life could be long, and if it was, I'd have many options to return to my career," says Gang of Nine member Janet Nezhad Band, a Harvard University BA, JD, and MBA who quit her job as a senior counsel at MTV Networks in 1997 to raise her two kids. "But if life is short, I want to spend it with them."

The growth of the stay-at-home-for-now phenomenon is showing up in the latest Census Bureau figures. After rising steadily for a quarter-century, the number of women with children under age 1 in the workforce dropped from a record high of 59% in 1998 to 55% in 2000. Although small, it's a significant change. But experts point out that the slide could be short-lived, especially given the economic downturn and legions of layoffs.

What is clear is that the new wave of stopping out appears to be concentrated most among the best-educated and highest-achieving women—those in their 30s and 40s who have college degrees and, often, wealthy husbands. The '90s stock option bonanza allowed many of these dual-earner families to live well on a single income. Federal Reserve data show that nearly half of households earning \$250,000 to \$499,999 now have just one breadwinner, up from 38% in the early 1990s. Moreover, now that 1 in 3 women are outearning their husbands and younger generations are rejecting the values of the



IDENTITY SHIFT

Yale and Columbia Law grad Turaj "had to create a new concept of feminism for myself. It's really about offering you the choice to be the person you want to be"

money-and-work-obsessed 1980s and '90s, more men are dropping out, too; the number of children living with stay-at-home dads has soared 70% since 1990, to 1.7 million, according to 2000 Census figures.

Gen X men and women consider the balancing of home and work their biggest challenge, and they also see it as their first priority—far more important than earning a mega-income or an impressive title, according to research by Catalyst. In a departure from the breakthrough generation, many of the successor women are finding a new comfort level with taking time off. Corporate layoffs are fast destigmatizing unemployment since so many managers are now often between jobs. Experts say the stay-at-home inclination also stems from watching older women frantically try to "have it all," achieving positions of success by age 40 only to find that their fertility had been sacrificed along the way.

Often, stopouts have racked up considerable track records, making them more confident about re-entering the workforce and not worrying as much as their predecessors did about a résumé gap sidelining them in perpetuity. "In my generation, if women took their foot out of the door for one second, it would slam shut," says Laraine T. Zappert, a Stanford University

clinical professor of psychiatry and author of *Getting It Right*, a new book based on research with 300 Stanford Business School alumnae. "Women have proven themselves to be highly competent assets in the workplace," says Zappert. "They can negotiate for things that weren't acceptable, or even imaginable, 10 or 15 years ago."

The status of motherhood has also changed dramatically. Pop culture and celebrity hype have made mommydom hip, creating a new archetype. Pregnancy is paraded, full-tummied, in form-hugging fashions. High-profile stopouts including iVillage Inc. founder Candace A. Carpenter, White House adviser Karen Hughes, and entertainer Rosie O'Donnell, are also giving the choice more credibility.

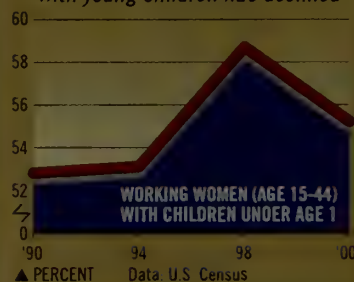
Granted, the vast majority of mothers still work and wouldn't have it any other way, especially since quitting can come with huge costs to psyches, finances, and careers. Beyond personal

losses, some worry that women overall could lose ground if the best-educated and most powerful are dropping careers to stay home. They fear an erosion in the gains in equality that have made it easier for women up and down the ladder.

It's a point well taken by many stopouts, many of whom are loath to be seen as copping out or

STAYING AT HOME: THE NEW MOMMY TRACK?

After rising steadily for years, labor-force participation among women with young children has declined





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The bottom line: High-powered jobs still don't allow for work-life balance. That drives a lot of talent away

women's-equality issues. But most also contend that feminism needs to evolve beyond its preoccupation with careers to value women's fertility and desire for family. Julie Turaj, a 30-year-old Yale and Columbia Law School grad, always envisioned that she would return to her job at a white-shoe firm in New York after the birth of her daughter Samantha two years ago. But she kept pushing back her return date until finally, after 18 months at home, she handed in her resignation. "I had to create a new concept of feminism for myself," she says. "It's really about offering you the choice to be the person you want to be—not keeping you under a glass ceiling at work but also not telling you that you are selling out the feminist revolution by choosing to spend time with your children."

For Turaj, leaving her job meant creating a new identity that wasn't forged solely from intellect. "As a lawyer, you can sit there and look at a brief and find an objective standard to determine how well you've done," she says. "As a parent, you can't do that."

Plus, after having slaved so hard for so long, the office no longer holds the same allure for many mid-career women. "I had to ask myself—is that all there is?" says Theresa Marcroft, a 44-year-old Silicon Valley executive who chose to take a break for a year to stay home with her daughter after getting laid off in 2000. In her job as marketing vice-president for Cylinc Corp., Marcroft traveled so much that she occasionally brought her child and nanny on European business trips.

Today, she's working as a marketing consultant, making two-thirds her old salary in half the number of hours. That's how many stopouts get back into the workforce—by avoiding traditional roles. Sabbatical returnees often

choose free agency over Corporate America, working as part-time executives or entrepreneurs. Some 61% of those in the Harvard study who said they had left the workforce but planned to return reported that they would seek nontraditional jobs—and that their goals were different than when they graduated.



WIRED FOR WORK

"I was never totally happy [during my five years at home]," says Pucciarello. "Not every woman needs to be with her children 100% of the day"

Adding to the complexity is the fact that women can't easily jump back into their careers once their kids hit first grade. Susannah Rabb Bailin, a Harvard MBA from the Class of '88, says she would advise young women to take breaks later. "[Children] come home as preschoolers, and it's: 'Can I have one cookie or two?'" But with older kids, the issues—sexuality, peer pressure, intellectual growth—get more complex. Adds Bailin: "Your presence feels far more important as your children get older—and no one tells you that."

Returning to work can also be difficult considering that stopouts are often

deeply involved in community fund-raising and their children's schools. A company's loss is often the community's gain, with many a school board, in its depth of experience and skills, resembling a corporate one. These women often throw all the energy and skill they poured into their careers into trying to create world-class childhoods for their kids.

But not everyone slides so smoothly into the role of stay-at-home mom. Aurora Pucciarello made the switch after her youngest son reached out for his nanny one night instead of her. Within a few months Pucciarello had sold her business, Max Distribution, a fast-growing logistics company. But staying home wasn't easy, either. "I was never totally happy," says Pucciarello. "It was a harder job for me to be home with my kids than to manage 125 employees." She found herself aching for an outlet and consumed with the need to work. She devised mad Martha Stewart-like projects, such as painting the inside of her 5,500-square-foot house herself. She doesn't regret her five years at home but realizes she's engineered for a career. "Personally I think God wires you a certain way. Not every woman needs to be with

her children 100% of the day."

Yet many careers demand 100% of women's energy and attention, making the combination of work and family a near-impossible setup. "There must be a new paradigm, a new way of organizing this so that all these amazing, talented people don't just have to bail out," says Gang of Niner Russell. "But I just couldn't figure it out." Until someone does, many moms will likely feel as if work-family balance is still more about "or," not "and."

By Michelle Conlin, with Jennifer Merritt, in New York and Linda Himelstein in San Mateo, Calif.

Your money. How's that for reality TV?



See inside

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THE BATTLE OVER A RADICAL NEW PLANE

Boeing seems to be dragging its feet on the blended wing

COMMENTARY

By Stanley Holmes

Boeing Co.'s future in commercial aviation rests on the outcome of an intense behind-the-scenes struggle over what kind of new airplane it should build next. Senior management in Boeing's commercial airplane division seems determined to take a conservative course, gradually upgrading the same kinds of planes the company builds today.

In contrast, a cadre of Boeing engineers wants the company to gamble on a futuristic, triangular-shaped aircraft design, dubbed the Blended-Wing Body, which Boeing inherited from McDonnell Douglas Corp. researchers when the two companies merged in 1997. They say this plane, the BWB, would be cheaper to build and fly than anything rival Airbus has on its drawing boards. And it could secure Boeing's leading position in the industry for at least another decade.

Managers who oppose the blended wing say the design has structural problems that outweigh its advantages. The argument has some merit: The radical design does not allow for windows at most passenger seats. The tailless BWB may also make for a bumpy ride compared with ordinary jetliners. And the composite materials needed to build the plane could prove more expensive than designers originally projected.

If such technical issues were really at the crux of this debate, BWB advocates within Boeing could probably address them. In fact, other forces are at work. Many critics inside and outside the company complain of a cultural shift in which engineering spirit is subordinated to financial concerns. Driven by the need

to produce profits, senior management has moved its focus to defense and space businesses, away from the hotly competitive commercial-aircraft market. When it comes to the blended wing, say sources, they are simply unwilling to take risks.

In some regards, Boeing's hesitation is understandable. Many of its customers on the commercial side are in dire financial straits.

And Boeing itself is under constant pressure from Wall Street to

show returns.

In at least one scenario, the company might ride the current wave of defense spending, contain losses, avoid risks, and emerge in a few years bolder and ready to build for the future.

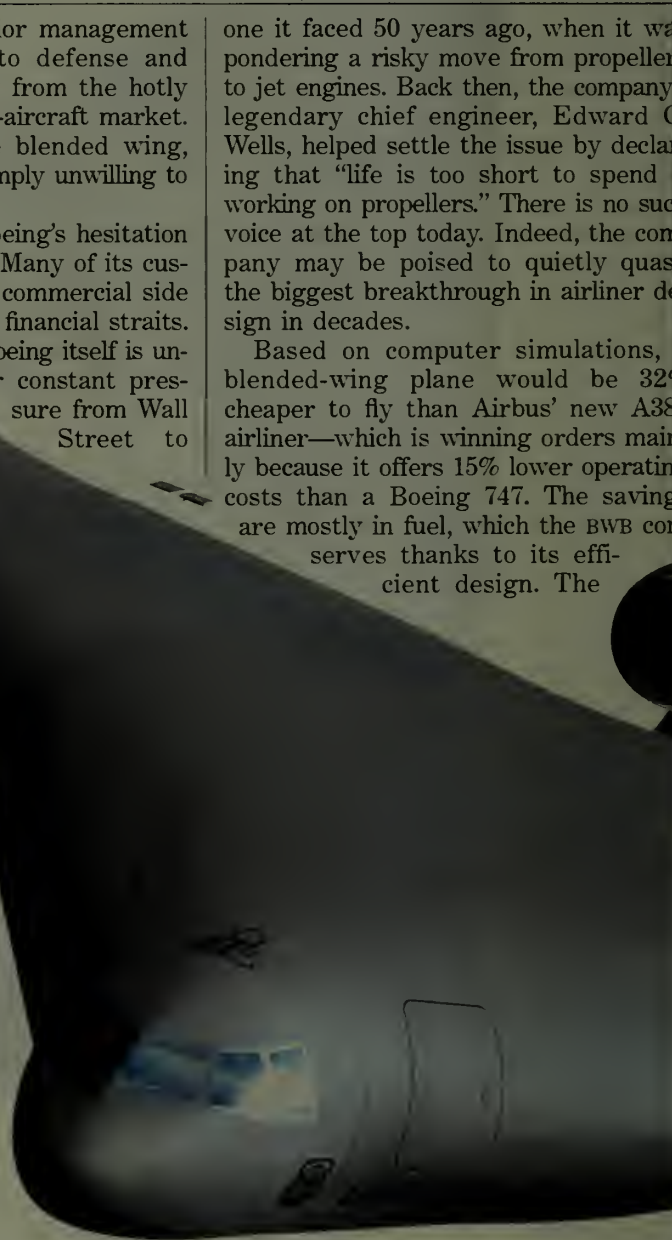
Nonetheless, Boeing's current conservative mood is troubling because the company is at a crossroads much like the

one it faced 50 years ago, when it was pondering a risky move from propeller to jet engines. Back then, the company's legendary chief engineer, Edward C. Wells, helped settle the issue by declaring that "life is too short to spend working on propellers." There is no such voice at the top today. Indeed, the company may be poised to quietly quash the biggest breakthrough in airliner design in decades.

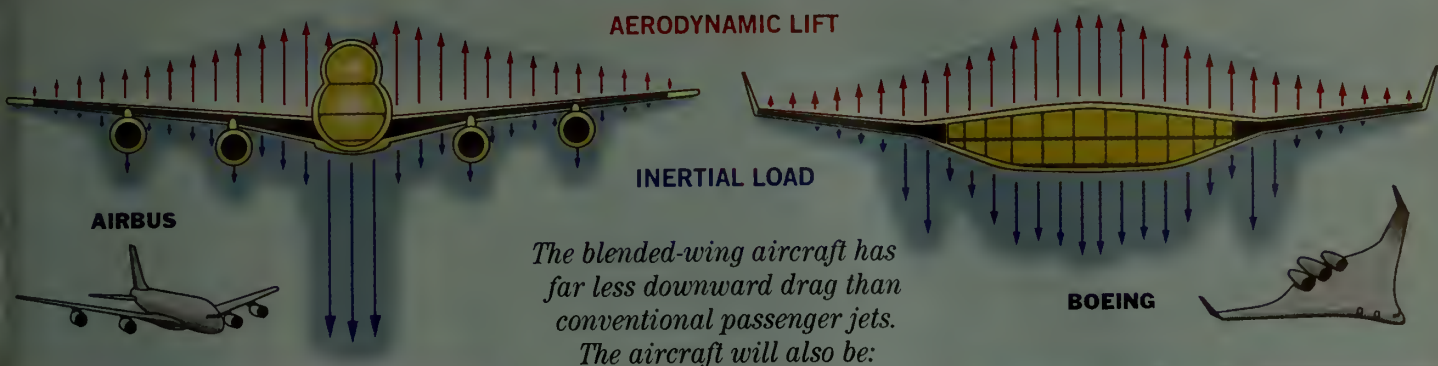
Based on computer simulations, a blended-wing plane would be 32% cheaper to fly than Airbus' new A380 airliner—which is winning orders mainly because it offers 15% lower operating costs than a Boeing 747. The savings are mostly in fuel, which the BWB company serves thanks to its efficient design. The

"There are no technical or economic reasons for this plane not to be built"

AN ARTIST'S CONCEPTION



WHY BOEING SHOULD BET ON THE BLENDED WING



ing has much more aerodynamic lift than drag, and the structure weighs less than conventional jets. Indeed, Boeing's studies show that the blended wing would be far cheaper to operate than any current or proposed airliner with 50 to 500 seats.

That's why at least four of the world's major carriers—Lufthansa, FedEx, Singapore Airlines, and United Airlines—want Boeing's commercial-airplane division to make the blended wing a priority. And some have urged Boeing to forget about another pet project, a high-speed jet known as the Sonic Cruiser. Airline execs haven't pulled any punches at meetings with Boeing officials. At a mid-October gathering, a senior European airline exec dismissed a Boeing manager's presentation, saying: "We do not want to talk about the high-speed and higher-cost Sonic Cruiser aircraft anymore." That plane would cut 5 to 90 minutes off long routes, but even its higher fuel costs, "we didn't see any value for the amount of time it could save," says Gordon McKinzie, director of new aircraft programs for United Airlines Inc.

Despite the fact that many execs are intrigued by the blended wing, Boeing doesn't seem to be listening to

CHEAP TO BUILD
Whether the planes are large or small—built for 250 seats or 450—wings, cockpits, and interiors may be interchangeable, so manufacturing costs might be 25% lower than for other planes in the same size range.

CHEAP TO OPERATE
In some cases, the new plane would consume 32% less fuel per seat-mile than conventional aircraft.

EASY ON ENGINES
Fully loaded with passengers and fuel, it's at least 18% lighter than conventional jets and will require up to 27% less thrust, depending on the size.

A NICE MATCH
Unlike the Airbus A380, the blended wing fits into the world's current airport loading systems. And it could be built in Boeing's existing factories.

Data: Boeing Co.

ered offering a billion dollars to help subsidize further development of the aircraft, industry sources say.

While senior Boeing execs at the commercial airplane division declined to talk to *BusinessWeek* about the blended wing or the Sonic Cruiser, other executives and engineers throughout the company were willing to speak privately and publicly about the prospects for both programs. And when those

Mulally repeated some of these complaints to Boeing managers at the company's St. Louis training center in October. According to sources who were present but decline to be named, when the BWB was raised during a question-and-answer session, Mulally made it clear that the blended wing has absolutely no future under his watch.

He won't even give the plane a full hearing. Boeing insiders say that neither he nor his influential second-in-command, James M. Jamieson, senior vice-president for airplane programs, will sit down for a face-to-face program review with Robert H. Liebeck, a senior technical fellow and chief designer of the blended wing, and a part-time teacher at Massachusetts Institute of Technology. Nor has Liebeck been allowed to brief CEO Philip M. Condit. On the other hand, sources say, former president and now board member Harry C. Stonecipher, CFO Michael M. Sears, and Chief Technology Officer David Swain are fans of the blended wing and seek regular updates on its progress.

Mulally and Jamieson declined to speak to *BusinessWeek*, and Boeing would not make Liebeck available for an interview. But other senior Boeing officials acknowledge a house divided. "The one challenge is overcoming the inherent resistance of people who build tube-and-wing airplanes," says George Muellner, Boeing's senior vice-president for Air Force Systems and former head of its research-and-development arm, the so-called Phantom Works. Still, Muellner is optimistic. He figures the BWB offers too many advantages to ignore. "It's going to earn its way into the marketplace," he predicts.

Meanwhile, inde-

its customers. The plane maker made little effort to provide technical briefings on the blended-wing design. Some airlines have actually paid to fly in the BWB program director for an official briefing—after which they invariably rave about what they heard. The enthusiastic customer even consid-

in the commercial division did weigh in, it was mainly to complain. The lack of windows was one magnet for criticism: The thick wing stubs cover the sides of the passenger cabin. Critics also fret that the aircraft won't be stable.

Commercial Airplane CEO Alan R.

pendent simulations provide ammunition for BWB's advocates. "There are no technical or economic reasons for this airplane not to be built," says Robert E. McKin-

What Boeing should do now is let the airlines take a close look at the design, so they can make a choice

ley, manager of NASA's blended-wing project, which helped fund the Boeing BWB program. "The plane has incredible potential. I can't see any big holes in it."

All this is creating confusion and consternation among the airlines. They are beginning to wonder if Boeing has a coherent long-term strategy. "The blended-wing concept provides great promise, and Boeing should officially present the program as soon as possible," says one senior foreign airline exec. "However, I and many of my colleagues in the airline industry do not understand what is going on at Boeing anymore."

They're particularly scratching their heads over the attitude toward cost advantages of the blended wing. The plane "has all the panache of the Sonic Cruiser but is focused on cost rather than speed—and that's a much more intelligent way to go right now," says Richard Aboulafia, aerospace analyst for Teal Group Corp. consultants.

Pursuing a new fleet of blended-wing passenger jets may be risky, but it could be Boeing's best hope of regaining leadership in commercial aviation. Sticking with familiar, conventional designs won't solve Boeing's long-term challenge. It doesn't need just one new plane—it needs a whole fleet of more modern aircraft. And they must be clearly superior to Airbus jetliners. For the first time ever, Airbus is expected to surpass Boeing in airplane deliveries next year, about 300 planes. Only three years ago, Airbus was delivering fewer than half as many jets as its U.S. rival.

Such competition highlights the opportunity staring Boeing in the face. Management should grab it—and let its customers, the airlines, evaluate the blended-wing concept thoroughly. Liebeck and his team have spent 12 years refining their design—10 years longer than the

amount of research devoted to the Boeing-developed Sonic Cruiser. Says FedEx Vice-President James Parker, who's in charge of aircraft acquisitions: "If Boeing were to offer a blended wing, we would certainly take a serious look at it."

The BWB concept also has huge potential as a military tanker, transport, and commercial freighter. Its wide fuselage means that as a tanker, the BWB could refuel three fighter jets at the same time. True, the plane's launch cost is estimated to exceed \$10 billion. But with Pentagon backing, Boeing

indicates that the ride would be similar to that of a Boeing 747. "As long as the pilot flies it like an airliner and not like a fighter jet, you won't sense it," says Boeing's Muellner.

The recent waffling at Boeing trains spotlight on the cultural shift within the company. In the past, old-timers recall the saying was: "We hire engineers—and other people." Boeing was a place where management encouraged open intense debates over designs, where a team led by chief engineer Wells could completely revise the design of the B-5

bomber over a weekend after the Air Force said it wasn't impressed with the first offering.

In the wake of the merger with McDonnell Douglas, profits not debate seem to be driving decisions. Wall Street initially hailed the deal as providing a better balance between Boeing's defense and commercial businesses. But perhaps that balance has tipped too far in favor of defense. The company has yet to launch a new aircraft to counter the recent market-share gain by archrival Airbus.

Many outsiders believe that Boeing's turmoil over the blended wing stems in part from the injured egos of managers. Emotionally, they may not feel comfortable backing a project that was hatched at McDonnell Douglas. I

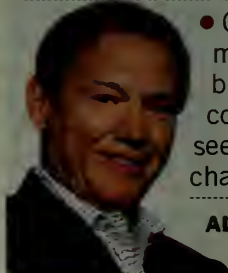
the not-invented-here syndrome is playing even a small role in Boeing's decision-making, Mulally and his senior executives need to reevaluate their position.

For now, Boeing is hanging back from what could be a quantum leap in technology, one that could yield significant benefits for the plane maker and its customers. The company owes it to its proud heritage—and shareholders—to investigate the blended-wing design comprehensively. At least then the final decision, gutsy or not, would be based on sound analysis. And it's a good bet that Boeing would see that boldness is better

THE BLENDED-WING AIRCRAFT: THE GOOD AND THE BAD

LIABILITIES

- The public will have to get used to flying in a plane with a radically different shape
- Only a few seats will have windows, which some passengers may find disturbing
- Plane is prone to abrupt soaring and dipping when the pilot turns and banks
- The flight-control system is complex, and there could be unusual strains on hydraulic equipment



• Composite materials used to build the aircraft could pose unforeseen manufacturing challenges

ALAN MULALLY

MERITS

- It could be built more cheaply and burn up to a third less fuel than other planes
- Boeing could construct a full range of different-size planes sharing key components
- Modular interiors create roomier cabins, with extra leg room for coach passengers
- It has potential as a freighter or military tanker that could refuel several jets at once
- Given military potential, the government may help shoulder research and development costs



ROBERT LIEBECK

Data: BusinessWeek

could probably get the government to help pay some of the costs.

Boeing has legitimate questions about whether some airlines might feel uncomfortable with a plane design that's untested in commercial-aviation circles. Yet the basic idea has been around for 50 years. A flying wing was built in the 1940s by Jack Northrop, founder of Northrop Corp., and the concept is still flying—as the B2 Stealth Bomber.

Another common objection is that because the passenger compartment is so wide, the people sitting in the outside seats could feel like they were riding a roller coaster as the plane banks and turns. But a motion simulator at NASA

Holmes covers aviation from Seattle

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Cancer will kill some 555,000 Americans this year. Among the victims so far: Dan Case, older brother of AOL Time Warner Chairman Steve Case. An investment banker in Silicon Valley, Dan died in June at age 44 of a brain tumor, a year after it was detected. "When Dan was diagnosed, I was very surprised to learn that no one knows what causes brain cancer or how to cure it, despite decades of work," says Steve. Instead of waiting passively for the inevitable, the Cases founded Accelerate Brain Cancer Cure last year, aiming to apply "results-driven strategies" to research. Steve now realizes no one organization, company, or government initiative can stop this scourge. As he told a Senate committee a few weeks before his brother died: "The only way we can find a cure is by working together."

SPECIAL REPORT

CANCER

The hope. The hype.
The reality.

Case's frustration is understandable. The three-decade-old war on Cancer has cost the federal government more than \$50 billion for research, and private industry has kicked in billions more. But the body bags keep piling up, and the statistics are even worse than had been assumed: The National Cancer Institute (NCI) discovered in October that incidents of the five most common cancers, thought to have leveled off since 1997, have done the opposite. Once the figures were revised, rates of lung, breast, prostate, colon, and skin cancers had steadily increased. Today, one in three people will develop cancer in his or her lifetime, and half of them will die within five years of diagnosis. In 10 years, cancer will likely surpass heart disease as the leading cause of death in the U.S.

There's no way to gloss over these grim numbers. Re-

markably though, most oncologists feel hopeful rather than helpless. Cancer treatment is finally on the verge of a transformation. This is no premature pronouncement about a cure. To be frank, most doctors in this field no longer use that term. Instead, oncologists envision a more realistic—and attainable—containment strategy. They're convinced that within five years it may be possible to use a windfall of new, precisely targeted drugs to keep cancer in check while patients live longer and relatively symptom-free lives, much as insulin is used to contain diabetes.

This is no pipe dream. Over a dozen new drugs have been accepted by the Food & Drug Administration for expedited review, each meant to replace chemotherapy. "We'll start to see an impact, and by that I mean prolonging of life, in the next five years," says Dr. Lee M. Ellis, an oncologist at M.D. Anderson Cancer Center in Houston. Further out, the outlook is more heartening. "Within 15 years, we should see major changes in many cancers resulting from the treatments we're

working on now," says Dr. Robert C. Young, president of Fox Chase Cancer Center in Philadelphia. "That's lightning speed in cancer research."

Patients may feel they've heard all this before. Back in the 1980s, interferon and interleukin-2 were heralded as magic bullets, only to produce little or no impact. The latest drugs are far more promising, but they must contend with cancer's nefarious tendency to develop resistance to almost any drug.

Still, oncologists are confident that this time they won't be disappointed. The past several years have yielded a wealth of insights into the mechanisms that turn healthy cells into killing machines. Researchers now

have the understanding they need to gum up the works of these cancer cells. Some 170 pharmaceutical and biotech companies are running clinical trials for over 400 innovative cancer drugs—far more than for any other disease category. As these drugs wend their way through the testing process, stories from the front lines of patient care signal that cancer could one day be a disease we can live with, not die from.

Ann Marie Reynolds, a 45-year-old nurse living near Albany, N.Y., had a persistent cough in August, 1999. Never having smoked, she wasn't unduly concerned. After a few weeks, she went to her doctor, and the news was about as bad as it can get: Reynolds had an advanced case of lung cancer. This disease is responsible for far more deaths than any other type of cancer—and less than 10% of its victims are non-smokers. In the next 12 months, Reynolds tried four different toxic chemotherapy drugs. Nothing worked, and by November, 2000, there were tumors in her liver. Her lungs were so blocked that she needed oxygen almost constantly.

Reynolds, however, is one of cancer's lucky ones—and perhaps, a harbinger. In January, 2001, she entered a clinical trial for AstraZeneca PLC's Iressa, a targeted therapy meant to stop tumor cells from spreading while leaving healthy cells alone. "There wasn't much hope. I knew the realities," Reynolds says. Still, she made the trip to Memorial Sloan-Kettering Cancer Center in Manhattan, oxygen tank by her

THANKS, THALIDOMIDE

The drug that caused horrific birth defects in years past has arrested growth of the brain tumor afflicting 22-month-old Melanie McDaniels. The downside: She may be dependent on it for life.

THE HOPE

A new generation of easily tolerated drugs will **REPLACE CHEMOTHERAPY** and turn cancer into a **MANAGEABLE DISEASE**, much like diabetes.

THE HYPE

Drug developers boast that new **TARGETED THERAPIES** will soon knock out cancer cells and allow patients to live long, **SYMPTOM-FREE LIVES**.

THE REALITY

Targeted drugs are **NOT A CURE** and most work only on a very small percentage of patients. Still, **BY 2015** they could transform cancer treatment.

side. Within a week of starting the daily pill, she could breathe on her own. In a few months the initial tumor shrank; it has yet to grow back. The only side effect was a severe, acne-like rash that cleared up after two months. "It's wonderful," she says. "For the first time since I was diagnosed, I feel hope. I'm considering going back to work."

Stories like that highlight the complications of cancer research as much as the triumphs. On Sept. 24, an FDA advisory panel recommended Iressa for approval, based on a clinical trial showing it shrank tumors in 10% of advanced-stage lung cancer patients. That's

Special Report

considered a significant result in such sick patients, even though there's no evidence the drug prolongs life.

Still, negative news may cause the FDA to reject the drug when it considers Iressa in January. In Japan, where Iressa was approved this summer, 39 deaths from pneumonia have been associated with the drug. And in August, a separate trial found that newly diagnosed lung cancer patients who received Iressa in combination with chemotherapy didn't respond at all. "This is exactly the opposite of what everyone expected, which is that Iressa given early would get a better response," says Eric Dupont, CEO of Canadian biotech AETerna Laboratories Inc.

The disappointing results were a blow to the whole field of cancer-drug development—and hardly the first one. Last May, Protein Design Labs Inc. reported that 36% of leukemia patients responded to its drug Zamy, but failed to live longer than those on standard chemotherapy. In September, trials of Genentech Inc.'s Avastin failed to show improved survival. ImClone Systems Inc.'s controversial drug Erbitux seems to help some colon cancer patients, but the trial data have been called into question.

What's going wrong? "When targeted therapies work, they are really helpful," says Dr. Mark G. Kris, in charge of Iressa trials at Sloan-Kettering. "But they don't work for everybody." That is the catch-22 facing companies struggling to come up with new cancer weapons. Although trial after trial shows that targeted therapies can be highly effective for a small subset of patients, there is no easy test to identify them. If the wrong patients end up in a clinical trial, success rates could be too low to win a nod from the FDA.

From a business perspective, drugs that address only a small demographic may seem problematic. But the drug industry has shrugged off this worry—virtually all the cancer drugs in human trials are targeted therapies. The companies reason that patients who do improve on a given drug may take it for the rest of their lives. That translates into a lot of revenue: Iressa costs \$3,000 a year in Japan. Analysts do not expect payers to balk at those prices, given the alternatives.

The National Institutes of Health estimate that cancer cost the U.S. \$60 billion annually in direct medical costs (including \$8.8 billion for drugs) and a further \$120 billion in lost productivity due to illness and premature death.

Big Pharma and biotech firms alike are pushing ahead with targeted therapies. Novartis has 10 cancer drugs in development, and "from 2005 onwards, our new launches are almost exclusively oncology products," says development head Jorg Reinhardt. Biotech companies are even more heavily invested because most targeted therapies stem from biological rather than chemical discoveries. "We expect the cancer sector to be the fastest-growing in biotech, given the rate of innovation," says analyst Dr. Mark Monane of Needham & Co.

Those innovations are based on two decades of painstaking progress in deciphering the molecular underpinnings of cancer. Scientists have identified a dozen or so genes, along with the hundreds of different signals they emit—often referred to as pathways—that turn a normal cell malignant. Transforming these discoveries into treatments has been arduous. "Drug development takes forever," laments Genentech CEO Arthur D.



WHEN CHEMO FAILS

After her lung cancer spread to her liver, Ann Marie Reynolds entered a clinical trial for Iressa, a targeted therapy from AstraZeneca. Now, one daily dose is keeping the disease at bay.

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Levinson. On average, it takes 15 years to go from lab to market—and the first genes associated with cancer were discovered only 20 years ago. Still, hundreds of different methods for blocking cancer signals have been developed. “The good news is that there appear to be a limited number of pathways that underlie the development of most tumors,” says Dr. Bert Vogelstein, oncology professor at Johns Hopkins

University Medical Center. “But just as there are many ways to skin a cat, there

are hopeful that an arsenal of targeted therapies will be able to overcome drug-resistant cancer cells. In an ideal future, an oncologist will analyze a patient’s tumor, determine which cellular mechanisms drive its growth, and choose the drugs designed to shut them down. As soon as one drug stops working, the patient would switch to another. It’s not a cure, but this prospect may be as good as it gets for cancer. As long as the pool of drugs can be constantly replenished, many patients may be able to hold illness at bay indefinitely.

First, though, drug developers must figure out how to get a targeted therapy to work on more than 10% to 15% of patients. The lowest response rates are for victims of solid tumors that start in the lung, colon, breast, or prostate, which make up 50% of all cases. These cancers, unlike CML, are caused by multiple defects. “Gleevec was an important step forward in demonstrating how to take a single genetic alteration and translate it into a new drug,” says Homer I. Pearce, vice-president of cancer research for Eli Lilly & Co. “The treatment of solid tumors is going to be very different.

The required approach in such cases will almost certainly be a drug cocktail. Targeted therapies will initially be used with chemotherapy, and eventually with one another. Dennis Slamon, a leading researcher at the University of California at Los Angeles, is already testing Genentech

Special Report

are many ways to inactivate a pathway.”

Unfortunately, choosing the right point of intervention is just one challenge. Cancer cells can learn to evade the smartest therapy. The cancer community overlooked this fact in April, 2001, when the FDA approved the first targeted therapy, Gleevec. Novartis’ drug blocks the action of a single defective gene responsible for chronic myeloid leukemia (CML), a rare cancer of the blood. It was heralded as a near-miracle because 80% of patients improved. Then came the rude awakening: CML cells in some patients quickly mutated until they were resistant to Gleevec.

Just as infectious-disease specialists keep trying new antidotes to drug-resistant microbes, however, cancer specialists

CONTROLLING CANCER

Cancer is caused by defects that occur when healthy cells divide and die off, a process that occurs millions of times in a lifetime. **ONCOGENES** direct cells to divide and multiply and **TUMOR SUPPRESSOR GENES** order old cells to die.

CLEANUP GENES correct mistakes made during the cycle. The longer one lives, the likelier these defects will pile up until one or more of the three types of genes goes haywire, and cells multiply out of control. Eventually, they can spread, or metastasize, throughout the body.

BLOCK GROWTH FACTORS

Drugs stop proteins emitted by oncogenes that encourage cells to proliferate wildly.

Examples:

- Iressa (AstraZeneca)
- Erbitux (ImClone)
- Tarceva (Genentech/OSI)

Scientists are pursuing four main avenues to rein in out-of-control cells...

ENTICE CELLS TO DIE

Drugs reactivate the tumor suppressor genes or block enzymes that protect cancer cells from dying.

Examples:

- Velcade (Millennium)
- Advexin (Introgen)

MOBILIZE THE IMMUNE SYSTEM

Vaccines and other immunotherapies train the body’s immune system to go after cancer cells.

Examples:

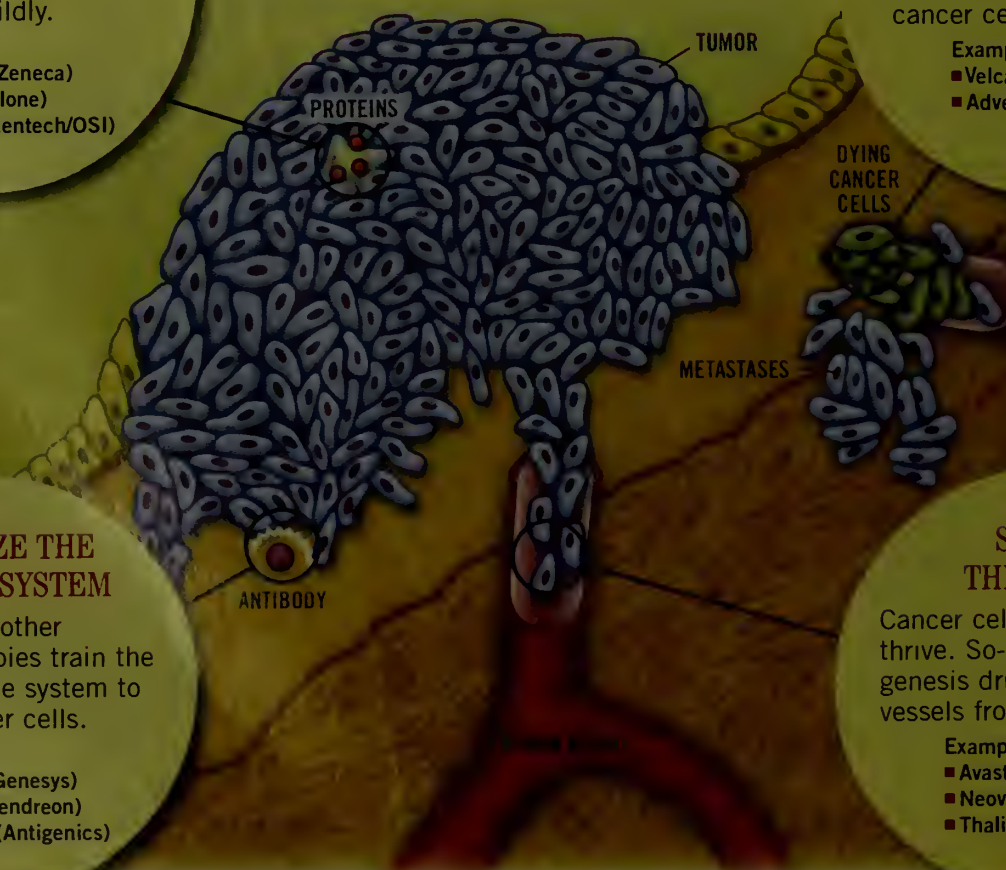
- GVAX (Cell Genesys)
- Provenge (Dendreon)
- Oncophage (Antigenics)

STARVE THE TUMOR

Cancer cells need blood to thrive. So-called anti-angiogenesis drugs stop blood vessels from reaching them.

Examples:

- Avastin (Genentech)
- Neovastat (Aeterna)
- Thalidomide (Celgene)



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WAR ZONES

**70% of all deaths
occur in just SEVEN
cancers**

Lung	154,900
Colon	48,100
Breast	40,000
Prostate	30,200
Pancreatic	29,700
Lymphoma	25,800
Leukemia	21,700

2002 ESTIMATES, AMERICAN CANCER SOCIETY

Herceptin, a breakthrough breast cancer drug approved in 1998, in combination with two of Genentech's experimental targeted therapies, Avastin and Tarceva.

Such cocktails will face their own special hurdles. Longtime competitors will not easily agree to join forces to test their experimental therapies together. Even if they do, the FDA has rarely allowed experimental drugs to be tested in combination, preferring to see a drug prove efficacious as a stand-alone. "The FDA has to get more realistic," says Dr. Eric P. Winer, director of the breast cancer unit at Dana-Farber Cancer Institute in Boston. "Most new drugs are not designed to be home runs on their own, and they should not be judged as though they are."

The more clinicians work with targeted therapies, the more convinced they are that no drug on its own can win; there are simply too many pathways tumors can use to spread through the body. To complicate matters, the same paths are used for normal cell division. It's only when a cell starts to divide uncontrollably that the paths facilitate a killing machine.

It is the normal and continuous renewal of the body's cells that sets the machine off (table, page 114). As cells divide and die—a balancing act that occurs millions of times over—tiny mistakes are made and

Special Report

copied into the two sets of genes that control the process. Another set of cleanup genes corrects these mistakes, but over time they can become overwhelmed. The longer a person lives, the more defects pile up—until a gene goes haywire. The balancing act is disrupted, and cells multiply out of control.

Targeted therapies aim to reintroduce balance. First, a patient's defective pathways are identified, then the proper antidote, or antidotes are administered. "I can imagine a scenario where five pathways are significant," says Dr. George D. Demetri, a medical director at Dana-Farber. "If you block all five, you have major containment—but you have to hit all five." That prospect, he admits, is humbling, but it can be done.

There are four leading contenders among the many containment strategies:

STARVING THE TUMOR

Melanie McDaniels of Londonderry, N.H., is a typical 22-month-old—except that she has a brain tumor. She started having seizures at five months, in June, 2001. Childhood cancer is not the death sentence it once was—about 50% are cured—but it is the second leading cause of death, after accidents, in children under 15. Melanie's prognosis was grim after two operations failed to stop the tumor's growth. "We thought it would be hopeless. What could possibly fix this?" recalled her father, Paul, who left his job to care for his daughter.

Last November, in a last-ditch

effort, Melanie's mother Amy got in touch with Boston's Children's Hospital. Mark W. Kieran, director of pediatric neuro-oncology at nearby Dana-Farber, enrolled Melanie in a clinical trial of four powerful drugs meant to shut down the blood supply to the tumor, essentially starving it to death. One of the four was Thalidomide, the drug that caused horrific birth defects when taken by pregnant women in the 1960s. It has since reemerged as a cancer drug because of its ability to stop blood vessel growth. The treatment requires a weeklong hospital stay every 21 days while Melanie receives the infusions. "We decided that, if anything, it might carry her along till they found something that would work," says Paul. But the little girl surprised even

one. Her tumor stopped growing, and she's now running around like any other toddler.

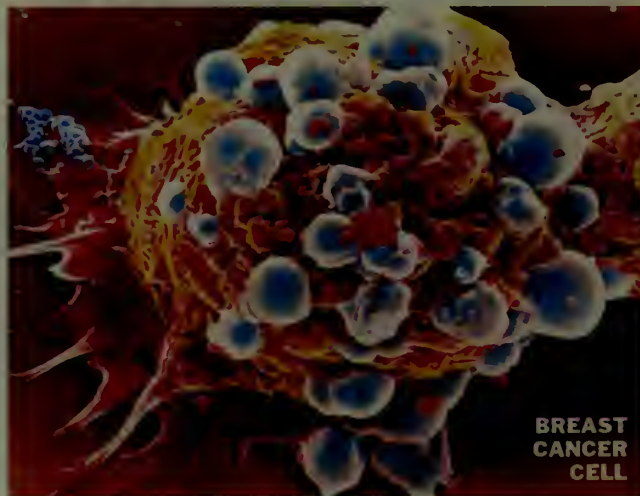
Treatments that block blood-vessel growth are called anti-angiogenesis drugs. The group as a whole has had more failures than successes, but there is still a firm belief that cutting off cancer's blood supply can stop it in its tracks. More than 40 anti-angiogenesis drugs are in clinical trials, and they are likely to end up being more complementary than competitive. Dr. Judah Folkman of Children's Hospital, father of the anti-angiogenesis field, says that as tumor cells mature, they call on multiple pathways to encourage blood vessel growth. "By using more than one of these agents, we might be able to block the full angiogenic output of the tumor," he contends.

Genentech's Avastin is the furthest along of this group. It may be having problems, however, because it blocks only one pathway, the protein VEG-F. Another drug in this class, Aeterna's Neovastat, hits at least four anti-angiogenesis pathways. Neovastat doubled the survival of kidney-tumor patients in early clinical trials and is now in phase-3 trials against kidney and lung cancer and multiple myeloma. Aeterna expects to seek FDA approval late next year.

BLOCKING GROWTH

The largest category of targeted therapies in development blocks proteins that encourage cell growth. All cells need such growth factors, but cancer cells take far more than their fair share. The most common, epidermal growth factor (EGF), is found in large amounts in more than 50% of solid tumors. At least 10 anti-EGF drugs are in clinical trials, including Iressa and ImClone's Erbitux, but none has yet proved its worth unequivocally. Specialists place the blame, in part, on the difficulty in determining exactly which patients are most receptive to an anti-EGF drug.

Again, one way around the problem may be to administer a cocktail of growth blockers, and a number of other ways are under study. Similar to EGF is an insulin-like growth factor called IGF-1, which seems to affect growth and blood-vessel production.



BREAST
CANCER
CELL

**Clinicians who work
with targeted therapies
are convinced no one
drug can win the game**

"Media businesses can only be as creative as the urban environment in which they operate. For us, Berlin is both an inspiration and a source of creative tension. This is exactly what brought us here. For an international company like Universal, the challenging atmosphere of Germany's capital city is simply ideal to develop innovative ideas."

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tion. IGF drug development is still in its infancy, though Immunogen Inc. in Cambridge, Mass., is expected to start human trials in the next two years.

THE DEATH STAR

Cells of all living organisms are programmed to die at some point to make room for new cells, a process called apoptosis. In cancer, apoptosis stalls out, allowing tumor cells to live long past their sell-by date. Several biotech companies are testing drugs that trigger the gene responsible for this process, but they face a tough challenge: It's harder to turn a gene on than off.

Millennium Pharmaceuticals Inc. is trying a different tack by avoiding apoptosis genes altogether. Its Velcade drug, currently in phase-3 trials, blocks overprotective enzymes that prevent cells from dying. There's a lot of excitement in the cancer world about Velcade because it is one of the few targeted therapies that has not experienced setbacks. When tested against the blood cancer multiple myeloma, Velcade stabilized or reduced disease in 77% of 78 patients.

However, the drug has yet to prove itself against solid tumors, which are far more common than blood cancers. For those, the most popular apoptosis target is the p53 gene, which plays a role in purging defective cells. P53 is inactivated in more than 50% of solid tumors, and at least four biotech outfits are developing drugs that would turn it back on. Advexin, for example, from Introgen Therapeutics Inc., uses a deactivated virus to deliver a working p53 gene to the patient. Advexin is in phase-3 trials against head and neck cancer and in early tests against lung cancer.

LIFELONG PROTECTION

Cancer patients know all too well that they are never out of the woods. Cancer cells can reappear years after "successful" treatment, and recurrence usually kills. When John L. Willey, 57, was diagnosed with prostate cancer at age 40, he had his entire prostate and surrounding tissue removed, but 12 years later the cancer was back. The father of two sons, now 16 and 10, Willey decided to try buying time with a vaccine that would train his immune system to take out the tumor cells. He enrolled in a clinical trial at Johns Hopkins for GVAX, from Cell Genesys Inc., and got two shots a week for eight weeks. So far, the cancer has not resumed its spread. "I know I have a disease that is incurable," says Willey. So he is lobbying for enrollment in a trial for a new, stronger version of GVAX.

Immunotherapy is the great hope of many cancer specialists, and the most elusive: It is devilishly hard to get the body to de-

fend itself against a homegrown enemy. Plenty of biotech startups are determined to find a way, and are responsible for some 70 vaccines in development. New York's tiny Antigenix is a case in point: Its skin cancer vaccine, HSPPC-96, generated considerable buzz in October when data from a phase-1 trial showed that it eliminated tumors in 2 of 28 patients with advanced skin cancer, and stabilized the disease in three.

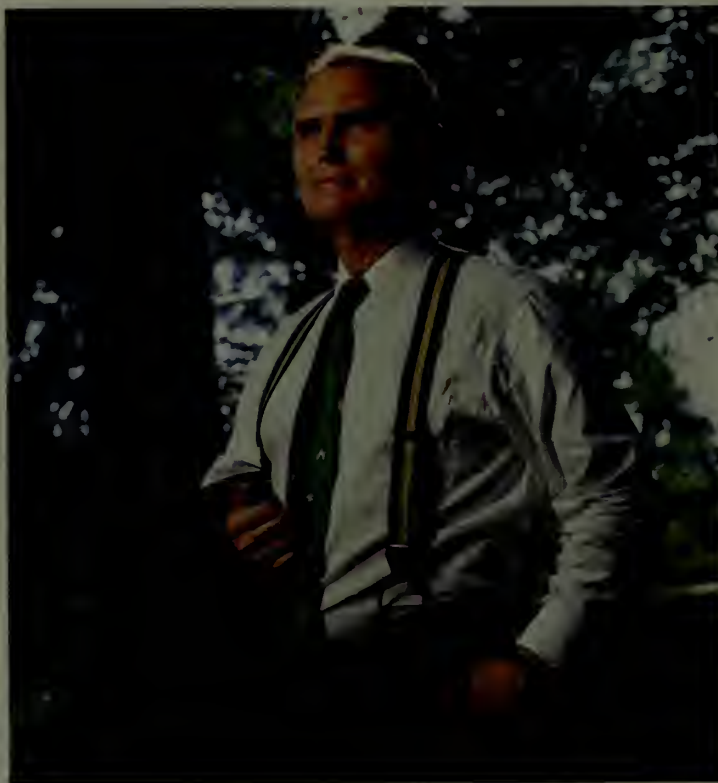
These drugs have more safety hurdles to overcome than other treatments, however. Because cancer cells so closely resemble normal ones, there is a danger that a stimulated immune system will go after both. It doesn't help that many of the early candidates failed clinical trials. This year, however, cancer vaccines are in late-stage trials. "I think several of these have a good chance of success," says Monane.

Of course, all of these initial targeted therapies could wash out. But researchers insist that early failures should not discredit the entire field. "There could be a problem with the design of the clinical trial, or the drug may need to be tweaked to improve its effectiveness," says Dr. Geoffrey Duyk, chief scientific officer of Exelixis Inc., which has several drugs in preclinical development. "I think the biggest threat to the whole field of cancer research is people giving up too soon. One need only listen to patients to realize this truth."

Perry Colmore, a 60-year-old former newspaper editor in Massachusetts, was diagnosed with breast cancer in 1987. She had one breast removed, and the second one in 1995 when the cancer returned. By then the disease had spread to her lymph nodes. "I figured I was dying and was ready to give up," she says, "but a wonderful social worker convinced me to keep going." Colmore went through a brutal chemo regimen at Boston's Beth Israel Deaconess Medical Center, 3 rounds of radiation, and took tamoxifen, a hormone-based treatment, for six years. She also started meditating, gave up drinking, changed her diet and moved from a Boston suburb to Martha's Vineyard. Six months ago, she started a clinical trial for Femara, promising breast cancer drug from Novartis. She has suffered

from multiple side effects from all these treatments: among them pleurisy, asthma, arthritis, and weight gain. Still "asthma's a lot better than being dead," she says flatly. "It's pretty annoying that we don't have a cure and we don't even know why we're getting cancer," Colmore admits. Nevertheless, "I have a feeling a lot of miracles are being worked."

With John Carey in Washington, Arlene Weintraub in Los Angeles, and Kerry Capell in London



BOOSTER SHOT

When John Willey's prostate cancer recurred, he signed up for a trial of GVAX, from Cell Genesys. The vaccine is training his immune system to find and eliminate tumor cells.

BusinessWeek online

For stories on the causes of cancer and more efforts by scientists to contain it, go to the Nov. 25 issue at www.businessweek.com

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Special Interview



James C. Morgan
Chairman and CEO
Applied Materials, Inc.

The longest-serving CEO in Silicon Valley and recognized as one of "The Good CEOs" by BusinessWeek. Mr. Morgan will be interviewed by **Kathy Rebello**, BusinessWeek's assistant managing editor. We'll get his candid assessments of leadership in a single-digit growth environment, the future for the technology industry, and more.

Special Address



John A. McKinley, Jr.
EVP, Global Technology and Services
Merrill Lynch

Merrill Lynch's nationally-recognized EVP responsible for global technology will talk on Managing for the Next Decade – A View from the Buy Side.

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Mapping the Post-Hype Marketplace

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Cover Story

Scott G. McNealy looks mighty calm for a man running a company whose stock has cratered. In the past two years, shares in Sun Microsystems Inc. have plunged from \$64 to a lowly \$3.28. A cool \$195.1 billion in market cap has evaporated. Subtract Sun's cash from the equation, and investors value the company at barely \$1.63 per share, less than they'd pay for a slice of pizza.

JAN. 31, '00

39.2

Now, from the coffee bars to the research and development

AUG. 31, '00

63.4

symbol of ingenuity and dynamism, is looking more and more like a relic of a free-spending era that's long gone.

McNealy, Sun's chairman and chief executive, says he's not fazed. Throughout Sun's 20-year history, he has grappled with crises before, struggling to convince skeptical investors, customers and employees that Sun could transform itself. Each time, he pulled it off. In the early 1990s, tech

pundits said Sun should ditch its workstation business and jump on the cheap Intel-Microsoft Windows bandwagon. McNealy wouldn't listen. He went the other direction and built bigger and more powerful machines, setting up Sun to take advantage of the Internet boom. These days, the

While investors worry about the company's very survival, CEO McNealy is plotting a path to supremacy

WILL SUN RISE AGAIN?



THE SUNNYVALE
(CALIF.) CAMPUS IS
HEADQUARTERS FOR
SUN'S AMBITIOUS
SOFTWARE RESEARCH

NOV. 12, '02

3.28

48-year-old CEO, dressed in his trademark jeans and sneakers, says matter-of-factly that he understands why investors are treating his stock so poorly. "We're not making money."

Worse, sales have taken a nosedive, down 32%, to \$12.5 billion, from a high of \$18.3 billion two years ago, as net losses over the past five quarters, excluding special charges, have mounted to \$307 million. In the past two years, gross profit margins have skidded by 20%. Top managers, including highly regarded President Edward J. Zander, have jumped ship. And yet McNealy clings tightly to the formula that has worked for him before. It calls for stubbornness, hard work, and faith that the research and innovation that have kept Sun at the head of the industry through the years will come to the rescue.

There's no time to waste. A fearsome posse of competitors, from Dell Computer to Microsoft and Intel, is battering its way into Sun's core market for computer servers, selling low-cost machines at a fraction of Sun's price. A few years ago, servers powered by Microsoft Windows software and Intel chips couldn't perform in the same league with Sun. Now they can. Worse, Linux' open-source software is making inroads into McNealy's market. It's created by legions of volunteers, and it's free—a price that's hard to beat. McNealy finds himself selling the tech equivalent of a Mercedes in a market of Honda buyers. "Sun will need to reinvent its business model," says Henry W. Chesbrough, a management professor at Harvard Business School.

Try saying that to McNealy. He maintains there's a home for Sun at the very top of the industry, safely above the Linux- and Microsoft-powered hoi polloi. He fiercely resists the notion that Sun's sophisticated servers could ever follow the brutal course of a commodity market. At the mention of the word "commodity," McNealy's eyes flash, and the Harvard alum growls that "a hammer is a commodity, a nail is a commodity. A computer is not a commodity."

But if those \$4,000 boxes rolling off the assembly lines at Dell Computer Corp. aren't technically commodities, they behave very much like them, pummeling prices in Sun's core business. Consider Sun customer E*Trade Group Inc. In August, the \$1.3 billion online financial-services company finished yanking out 60 Sun servers that cost \$250,000 apiece and replaced them with 80 Intel-powered Dell servers running Linux that cost just \$4,000 each. That took a huge bite out of expenses, including a

RIVALS AND TECHNOLOGIES ARE UNDERMINING PRICES...

LINUX This free operating software undermines Sun's Solaris. Linux servers are expected to triple to \$6.5 billion by 2005.

MICROSOFT WINDOWS Sales of Windows servers, which sell at a fraction of Sun's, are expected to rise 36%, to \$19 billion, by 2005—three times faster than Sun's market.

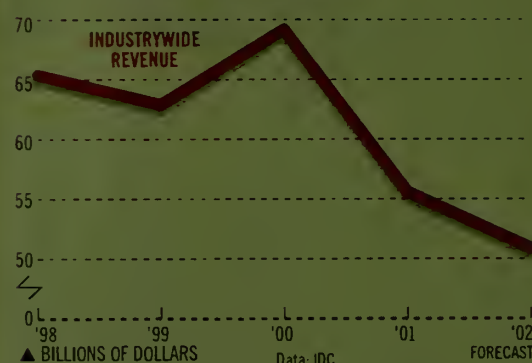
INTEL The chipmaker is selling microprocessors to work with Linux or Windows in priced machines as powerful as Sun's.

DELL With its low-priced servers, Dell has leapt to No. 2 in unit sales in the server market, with a 19.2% share, vs. Sun's 6.2%.

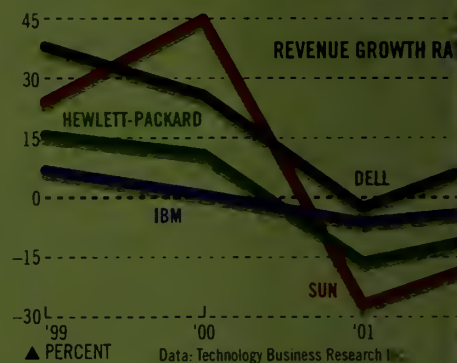
IBM Big Blue is a leader in Linux servers, and its software has grabbed 33% of the market for Internet infrastructure programs, vs. 9% for Sun.

Data: Gartner Inc., IDC

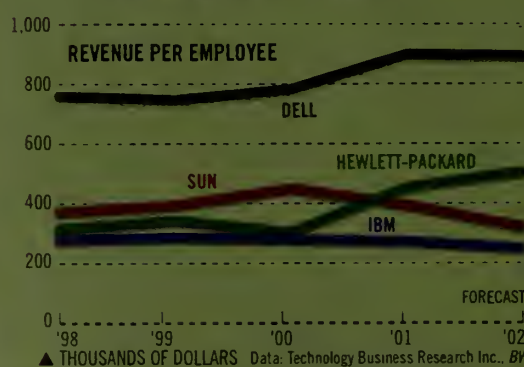
...WHICH IS DRIVING DOWN SERVER REVENUE...



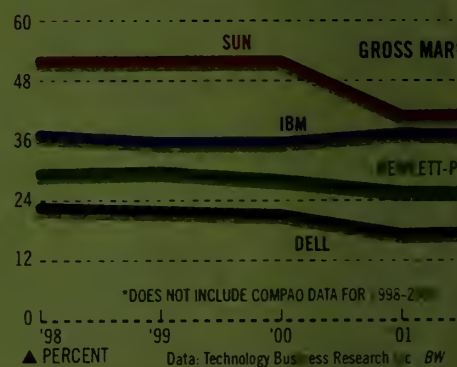
...LEAVING SUN WORSE OFF THAN RIVALS



AS SUN RESISTS LAYOFFS, PRODUCTIVITY SLIPS...



...AND GROSS MARGINS HAVE GONE INTO A SLIDE



ALL FIGURES ARE BASED ON A CALENDAR YEAR, EXCEPT HP WHICH ENDS ITS FISCAL YEAR OCT 31

Cover Story

one-time depreciation of the Sun gear and big maintenance fees. The savings so far: Nearly \$13 million—and the company expects to shave another \$11 million annually from its \$220 million tech budget. "It wasn't a hard decision," says Joshua S. Levine, chief technology officer at E*Trade. And here's the really painful part: When the Intel-powered machines break, E*Trade doesn't bother calling a repairman. It just junks the server and plugs in a new one.

McNealy is battling disposable computers. And even when he looks away from the cheap Dells, he finds little relief. In the pricey side of the business, IBM, with its horde of consultants, is swooping into Corporate America offering the ultimate in no-headache computing: It will take over the entire burden of running corporate computer systems for clients. Says Microsoft Corp. Chairman William H. Gates III: "In terms of products that meet the market's needs,

McNEALY'S PLAN FOR REIGNITING SUN

DOWN THE MONEY Software products generate gross margins around 80%, that of servers. McNealy has dedicated 1,000 salespeople to software. He's spending \$900 million on it, half Sun's R&D budget.

TO LOVE LINUX Customers are clamoring for Linux, the free operating system. In the fall, Sun rolled out Linux on its low-end servers. With time, it will run on the powerful boxes too.

ON CUTTHROAT RIVALS In a bid to grab 30% of the market for cheap Linux servers in a couple of years, McNealy has unveiled new servers as low as \$2,700. He's using Intel chips and outsourcing production in an effort to make money at that price.

UP SERVICES Sun has doubled its force of consultants, to 13,000, over the past years, getting 32% of revenues from services. Longer term, he hopes to offer more value consulting.

INNOVATION McNealy is betting that his outside R&D budget will allow Sun to become the first company to make software for smart networks that look after themselves—without calling on costly human help.

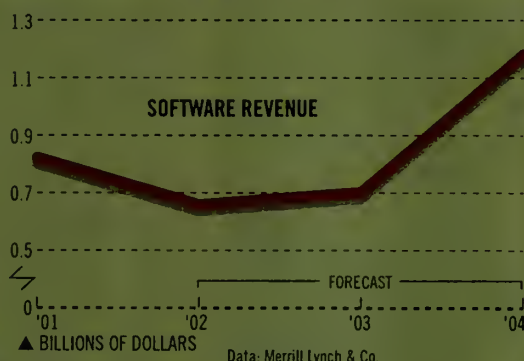


Sun has
a hoard
of \$5.2
billion in
cash and
securities

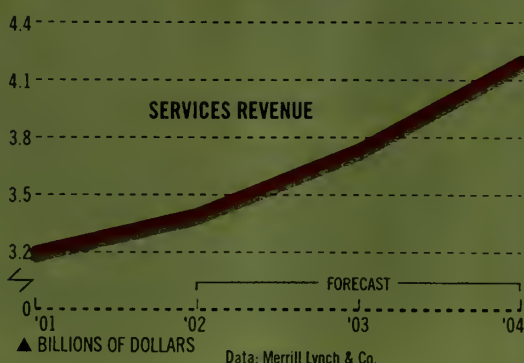
**McNEALY DRESSED
UP AS A PENGUIN,
THE LINUX MASCOT**



SUN'S BANKING ON SOFTWARE



SERVICES ARE CRUCIAL TOO



[McNealy's] in tough shape." Yet McNealy has a plan, one that he says will lift Sun not only back to profits but to the apex of the Information Economy. At the heart of the plan is Sun's classic franchise: heavy research and top-of-the-line computer systems. In a world of specialty players, Sun is a rare bird that designs its own chips and writes its own server software and computer chips. And McNealy's sticking to his integrated model. He's pouring research dollars into network software. His goal, stunningly ambitious, is to have Sun servers and Sun software running super-efficient networks of the future—marvels that run virtually free of human attention. In other words, while investors worry about Sun's very survival, McNealy, ever the contrarian, is plotting a path to supremacy.

And he has certain strengths to build on. By hacking costs, McNealy has stanchd much of the bleeding and says Sun will break even by next year's second quarter. Net income has taken a beating, but Sun has generated cash in every quarter of the downturn. In the fiscal quarter that ended in September, Sun's cash total was \$2.6 billion, up \$140 million from the kitty in the fall of 2000. Tack on \$2.6 billion in marketable securities, and McNealy has \$5.2 billion to play with. He's using that money to tidy up the books and spice up Sun's image. In the most recent quarter, Sun also bought back \$500 million worth of stock and paid off \$200 million in debt, bringing debt levels down to \$1.5 billion. And he's spending \$70

million on a worldwide ad blitz.

But the clock's ticking. Analysts say McNealy has only two years before low-end technologies in operating systems and chips catch up to his own. That's precious little time to defend the company from the onslaught—and to broaden his high-margin beachhead in software. It's fears about Sun's business model that are giving investors the willies. And financial worries are on the rise. On Oct. 16, Standard & Poor's lowered Sun's credit rating from a BBB+ to BBB, saying that Sun's profits would be too unpredictable in the coming year.

McNealy recognizes that hardware is unlikely to produce fat boom-level profits again. He's hoping that higher-margin software, which now makes up only 5% of Sun's revenue and an estimated 9% of profits, will pick up the slack. He won't predict when, but a bullish report from Merrill Lynch & Co. says that within two years Sun could generate up to 9% of revenues from software. That would

tack on an estimated \$417 million in gross profits.

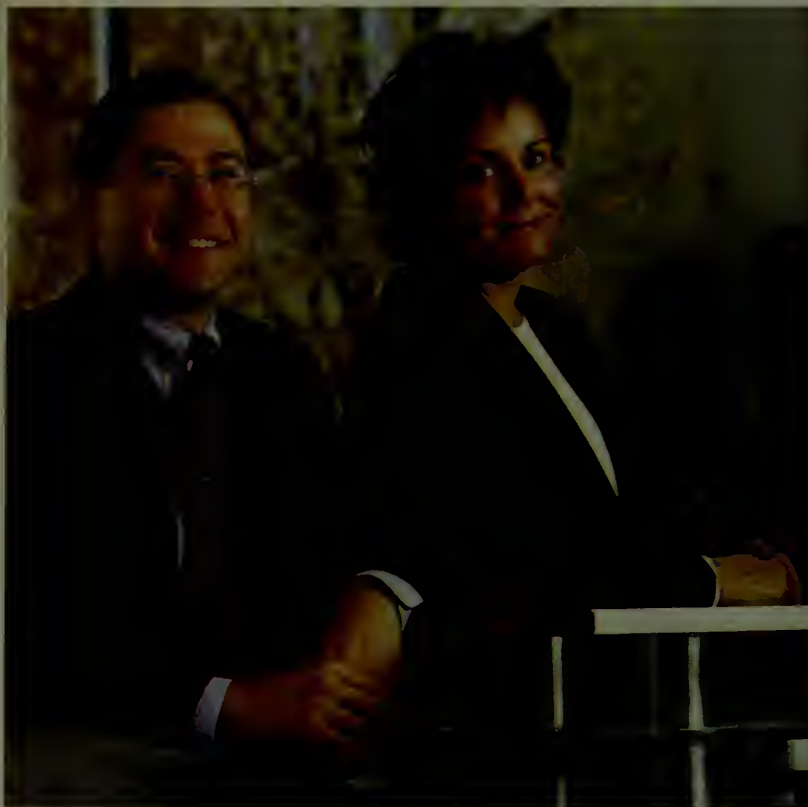
To reach that target, McNealy needs faultless execution and more than a little luck. He must come up with new network software that matches the best in the business, from IBM's to Microsoft's. It's a tough challenge for a box maker. Indeed, McNealy can only hope the company learned from its

failure in the late '90s when it treated software as an ugly stepchild to its boom-

ing server business—and blew a golden chance to run away with the market for e-business software.

McNealy must also plow into services, but without disrupting relationships with consulting partners, such as Electronic Data Systems Corp., that install Sun systems. Perhaps most difficult, he must convince workers, many of whom hold stock options that are deep under water, to bust their gut for a company many in the tech world are writing off. And they must hurry: If the cheap servers climbing up the

Cover Story



This year,
Sun has
shaved
\$600
million
in costs
from its
supply
chain

**SOFTWARE HONCHO
SCHWARTZ AND CON-
SULTING CHIEF SUELTZ**

food chain catch up to Sun's top line before McNealy's plan has traction, he's in trouble.

As McNealy leads his company up this steep slope, he'll doubtless face some tough choices. Like the pioneers who tossed their beloved pianos and rocking chairs before crossing the raging Missouri, he'll likely be forced to let loose a few of his precious technologies. High on the list are Sun's proprietary Sparc chips and Solaris server software, which together eat up more than \$200 million of R&D investment annually, according to analysts. But even here McNealy faces a dilemma. First, he has lots of customers who rely on maintenance and upgrades for these proprietary components. Cutting back R&D could cripple an important source of revenue. What's more, if he ditches the very pieces that make Sun special, he runs the risk of tumbling into the cutthroat commodity world below.

Will McNealy hoist Sun back to the top? More likely is a Sun that settles into a specialty niche, providing high-margin servers with all the bells and whistles built in, a path similar to the one trod by Apple Computer Inc. in the consumer market. A drearier possibility: Sun could follow the footsteps of

Digital Equipment Co., which failed to keep up with cost-saving changes in the computer industry and was eventually bought by Compaq Computer Corp. in 1998 for \$9.6 billion. "In a couple of years, if Sun can't turn it around, it could be acquired for its installed base and technology," says Steve Milunovich, a managing director at Merrill Lynch.

If McNealy comes up short, the effects will be felt far and wide. The ideas pouring out of Sun's labs have made the midsize computer maker into an outsize thought leader. Indeed, Sun has been strong enough to take on mighty Microsoft. Its Java programming language, which works on any operating system, remains an alternative to a Windows-dominated world. And many in the computer industry maintain that integrated manufacturers, like Sun and Apple, which focus on entire systems, generate far more creativity than the component-based champions such as Microsoft, Intel, and Dell.

Yet creativity doesn't always win the day. And as Sun struggles, Microsoft grows stronger. On Nov. 1, when U.S.

District Judge Colleen Kollar-Kotelly upheld a settlement among Microsoft, the Bush Administration, and nine states, the software giant emerged virtually unscathed from a four-year antitrust case, which Sun actively supported. McNealy refuses to talk about the settlement. "I don't get paid to get aggravated," he says.

Still, McNealy has long enjoyed a parallel career as the industry's anti-Microsoft ring leader. But now he barely has time for Bill-baiting. He has a company to rescue. Friends say it's times like these that get McNealy fired up. Tom Scott, chief information officer at General Motors Co., who worked at Sun in the late 1980s and played club ice hockey with McNealy, says McNealy is doing his job with the intensity he always brought to the ice. "He'll put his body on the line to get the

job done," says Scott, now a Sun customer.

McNealy is gripping the reins tighter than ever. He's working to put in place the management controls and succession planning learned at the side of the man he considers his mentor, former General Electric Co. Chairman and CEO Jack Welch. McNealy has cut a layer of management that kept him from execs on the front lines. He's acting like a battlefield sergeant, making sure his managers are following his strategy for facing the low-cost onslaught. In October, McNealy even moved his office from Sun's headquarters in Santa Clara, Calif.—a landmark building constructed in 1888—to Menlo Park so he could be closer to a customer center where he's spending most of his time these days.

When he's not meeting with customers, McNealy is making needed repairs to his company. In July, he created an executive vice-president position for software for the first time, organized all of Sun's consulting under one person, and assigned 1,000 salespeople to hawk Sun software.

But McNealy's first big management changes didn't come off as hoped. About 18 months ago, he started work on a succession plan patterned after what he had learned while sittin

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the board at GE. McNealy believed the timing was perfect. Several longtime execs, including Zander, wanted to leave the company. By last spring, McNealy had his plan in place.

When Zander left, McNealy would eliminate the president's position. When John Shoemaker, head of Sun's computer unit, retired, McNealy would take that position, too. This would cut out two layers of management, and more execs would report directly to the CEO. Just like Welch at GE, McNealy planned to evaluate and retain a new generation of leaders. At an April, 2002, powwow for Sun's 200 vice-presidents, he unveiled his plan.

Then it blew up in his face. Instead of presenting a cohesive management plan, McNealy, over the course of a month, dribbled out separate announcements for each of the five executives leaving the company, culminating with Zander. Coupled with the downturn in Sun's business, it looked as though the top people were jumping ship—or McNealy was forcing them out. When they said Ed was leaving, that's when I said to myself, 'Maybe I should think about looking for another job,'" says one former Sun employee. Sun's stock dropped 10% a week after Zander announced he was leaving. McNealy was so flabbergasted by the debacle he called Welch to ask what he did wrong. "Jack said, 'Don't worry about it. They'll forget about it soon enough,'" says McNealy.

Other concerns promptly leaped to the fore, led by Sun's sinking stock. For months, as Sun shares descended into single figures, McNealy turned a deaf ear to Wall Street and resisted further layoffs. He wanted to keep positioning the company, he said, to cash in on the tech recovery. But to a skeptical market he looked less like a determined visionary than a CEO in dangerous denial. On Oct. 17, with Sun's stock wallowing around \$3, McNealy finally bowed to the market and an-

Rivals such as Dell are pummeling prices in Sun's core server business

E*TRADE REPLACED SUN SERVERS WITH INTEL-POWERED DELLS



nounced a second round of layoffs. Combined with last year's cuts, he will have slashed 20% of the company's 43,700 workers.

Now he's hurrying to save money in operations. This year, Sun has shaved \$600 million in costs from its supply chain. That has saved five points on its gross margins. "If we hadn't done that, we'd be dead," says Marissa Peterson, executive vice-president of worldwide operations at Sun.

To kick-start business in the low end, McNealy is making a tactical retreat in servers. He has opened up a place for the commodity components, Linux and Intel chips, in his economy offerings. To proclaim his newfound love of Linux, McNealy showed up at a Feb. 7 conference in San Francisco in the costume of a penguin, the Linux mascot. The challenge for McNealy is to crack open a door to low-cost business without encouraging high-end customers to swarm through and switch to the cheaper fare.

McNealy has aggressive goals for the Linux servers. He's

Cover Story

TOUGH DECISIONS FOR SUN

McNealy faces challenges. Here's what experts say he should do:

THE DILEMMA

CHIPS Sun must decide if it can afford to spend \$200 million a year designing its own microprocessor, the Sparc, when it and Fujitsu are the only two major companies using the chip.

LINUX Customers want choices, and that's what they get with the open-standard Linux operating system.

EXPENSES If sales continue to slide, McNealy may have to tighten expenses even more than the 20% payroll cuts he has made so far.

MICROSOFT-BAITING Does Sun really stand a chance taking on Microsoft with StarOffice, a low-cost knockoff of the software giant's popular Office program?

THE FIX

► McNealy can phase Intel chips into most of Sun's servers over time. Power-hungry users will still pay a premium for high-end Sparc machines—at least until Intel crashes the party.

► Phase in Linux on Sun servers, starting with the low end. As Linux improves, cut back Solaris.

► At 14% of sales, Sun's R&D budget needs reduction surgery. And McNealy may have to proceed with further job cuts.

► McNealy has to pick his fights with Microsoft. Give this one up. It's a distraction.

Data: BusinessWeek

TODAY

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to push the boundaries**



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not airing them publicly, but several Sun executives say McNealy has told them that within the next two years he wants to grab 30% of what will then be a \$6.5 billion market, according to researcher IDC. To take on cutthroat rivals, McNealy is keeping costs low and outsourcing production of Sun's Linux machines, which start at \$2,700. That's a highly ambitious

Cover Story

goal, given that Sun has no market share today. But if McNealy can hit his target, the

low-end gear could add \$400 million in gross profits in 2004. That may be just enough to cover the slide in sales of Sun's midrange Solaris machines. The trouble with such calculations is that Dell and its low-cost collaborators represent a fast-moving target—one that slashes prices to woo new business. Merrill Lynch estimates that from 2001 to 2004, revenue in Sun's midrange will fall 60%, to \$1.7 billion. That translates into an estimated \$500 million hit on profits.

McNealy's bid hinges on his ability to focus the company on a handful of key initiatives. One is services. As Sun extends its business from the boxes to the broader network, it will be up to the service staff to help customers install the full gamut of Sun offerings. IBM has mastered this approach. And McNealy, who long denigrated the industry's march toward services, is now following suit. Sun has 13,000 service consultants, double three years ago. And while they're dwarfed by IBM's 180,000 consultants and HP's 65,000-member force, they appear to be gaining traction. In the most recent quarter ended Sept. 30, service revenues were up 9%, to \$879 million. Patricia C. Sueltz, Sun's executive vice-president in charge of consulting, targets \$1 billion in quarterly services revenue by next year.

Equally vital for McNealy is software. While Sun has been a bold software innovator, coming up with such advances as Java, software has remained a niche business marked by Sun's failure to turn leading-edge technology into sales and profits. Now McNealy needs it more than ever. Software is at the center of his vision of a Sun-driven networked world—and it delivers gross profit margins of 80%. It's little surprise that McNealy is plowing more than half of his R&D budget into software, much of it for Web applications.

Again, Sun risks new battles with old friends as the company plunges into different businesses. For years, Net software maker BEA Systems Inc. was an enthusiastic Sun partner. It created software to run on Sun's Solaris servers that let customers deliver applications effortlessly via the Web. Now, Sun's assault on the Web-software business has pushed BEA into the arms of chip giant Intel. Why? Unlike Sun, Intel isn't likely to compete in software. Now BEA is shipping a Linux version of its software to run on Intel chips, and sales

are taking off. In the last year, Sun's share of the BEA installed base has tumbled from 75% to 55%.

At the heart of McNealy's vision is an ambitious software project called N1. Sun's software developers have been working on the technology for two years, tucked away in a space-age data center at Sun's Sunnyvale (Calif.) facility. The idea is to create vast networks in which the software administers itself. If one computer runs out of memory, the software sees spare capacity elsewhere on the network. If the software develops a glitch, the program itself will work to fix it, without calling on costly human administrators. Sun will be releasing the first components of the program by the end of the year.

The trouble is, McNealy must invest heavily in N1 just to stay in step with competitors. IBM and HP are hard at work on very similar systems. On Oct. 30, IBM CEO Samuel Palmisano told customers that he was betting the future

of his company on a vast, N1-type project called "on-demand computing." He's investing billions to develop new products and will spend \$800 million on the market. And although HP CEO Carleton S. Fiorina keeps quiet, HP's version of N1, called Utility Data Center, already has 450 engineers behind it and 10 customers in pilot projects.

With all these challenges, it might make sense for McNealy to shelve his ongoing war with Microsoft. But he has trouble letting it rest. Since May, he's been offering a low-cost office-application package to battle Microsoft's ubiquitous Office desktop suite. This is David taking on Goliath without the slingshot. McNealy's colleagues urge him to focus on more pressing threats. Before a Sept. 1 speech to Sun customers at San Francisco's Moscone Center, his vice-president for software, Jonathan Schwartz, bet his boss \$2 that he couldn't avoid mentioning Microsoft during his speech. McNealy took the bet—and collected his money after his talk.

At the event, Sun's first big customer conference in seven years, dreadlocked drummers on stage were pounding a beat when McNealy jumped up, beating on a drum of his own. He promptly launched into a 45-minute stump speech defending Sun, one of the last of the integrated computer makers. "There is no automobile-integration industry," he says. "You get a car fully assembled. They even wash it for you." Joke and debating points aside, McNealy has to get Sun making money again. Only then will he convince the world that Sun can shine anew.

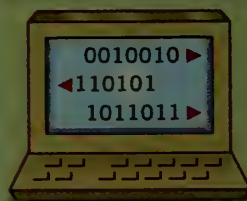
By Jim Kerstetter in Menlo Park, Calif., with Jay Green in Seattle and bureau reports

SUN'S ELDORADO

Sun is staking its software future on a vast project to automate the work in complex data networks. In September, Sun unveiled its nascent effort, called N1. Here's what it aims to do by mid-decade:



ONE SYSTEM Think of N1 as one huge operating system for the network. The software will automatically manage all of the computers, storage, and switches, making them work together as one giant machine.



VIRTUAL RESOURCES The software views all the tech gear in a corporate data center as one virtual pool of resources. If a big project taps out the supercomputer, N1 will automatically route the work to other computers.



LOW-COST COMPUTING By running computers close to capacity, the system will reduce the need for new machines. The software also will manage and update software installations. That will eliminate many of the tasks now handled by squadrons of systems administrators.

Data: Sun Microsystems Inc.

BusinessWeek online

For a Q&A with Scott McNealy and a closer look at N1, go to the Nov. 25 issue online at www.businessweek.com.

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PRO FOOTBALL'S REAL WILD MAN

A nasty trial has tarnished the *Jerry Maguire* image of superagent Leigh Steinberg. Can he still do the deals?

In the ego-driven, *Arli\$* world of sports agents, Leigh Steinberg seemed above the fray. He did record-breaking deals for the NFL players who flocked to his firm. But he also taught clients good citizenship, coaxing many to form charitable foundations and share their millions. Steinberg was even the model for the good-guy agent in the 1996 movie *Jerry Maguire*. And his best-seller on doing deals, *Winning with Integrity*, trumpeted core values.

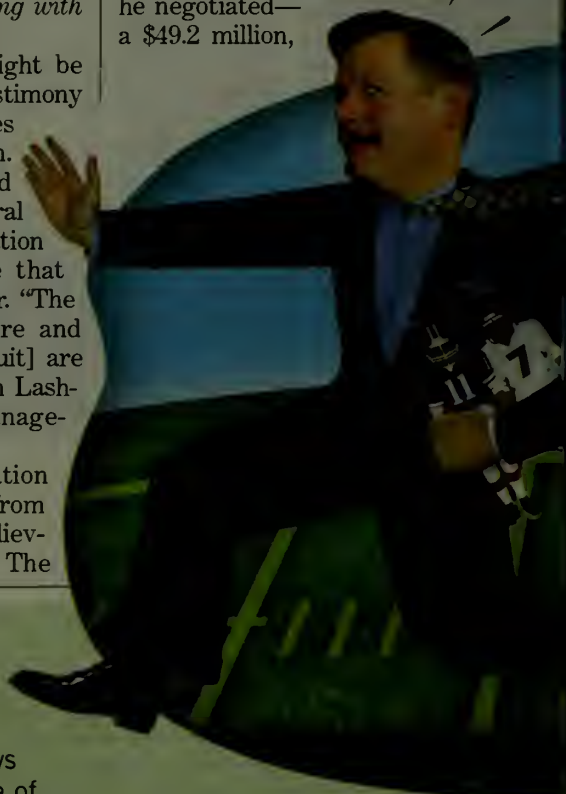
Winning with a Hangover might be more like it if you believe the testimony of former Steinberg associates about lubricated life with Leigh. In a six-week trial that concluded on Nov. 8 in a Los Angeles federal court, Steinberg's pristine reputation was thrown for a loss so huge that some wonder if he'll ever recover. "The image of Leigh Steinberg before and Leigh Steinberg after [the lawsuit] are totally different," says agent Lynn Lashbrook, president of Sports-Management.com in Portland, Ore.

Until recently, mere speculation that Steinberg, 53, could fade from the scene would have been as believable as a four-point field goal. The

freewheeling Newport Beach (Cal.) agent, who famously wore flip-flops close million-dollar deals, was among the most trusted brands in the industry.

That was before the bruising \$40 million lawsuit against former partner David Dunn. Last February, Dunn bolted from Steinberg's SMD Inc. to launch a competing firm, Athletes First—and took some 50 NFL players with him. In doing so, he decimated the firm that dominated pro football for 20 years.

Starting with one player in the mid-1970s, the 26-year-old Steinberg, fresh out of law school, began forging a powerhouse agency. As his reputation grew, so did the contracts he negotiated—a \$49.2 million,



FULL-CONTACT LAWSUIT

OCT. 1999 Assante Corp. buys out sports superagent practice of Leigh Steinberg, who has represented hundreds of NFL players—including star quarterbacks Steve Young and Troy Aikman.

FEB. 2001 David Dunn, a Steinberg partner, bolts and launches a new agency, allegedly taking more than half of Steinberg's 86 NFL clients.

MAY 2001 Steinberg sues Dunn seeking over \$40 million in damages.

OCT. 2002 A trial begins in U.S. District Court in Los Angeles. Dunn countersues for invasion of privacy and false advertising.

OCT. 2002 Steinberg's lawyers

Free
me.

Power
me.

Best of
both worlds
me.

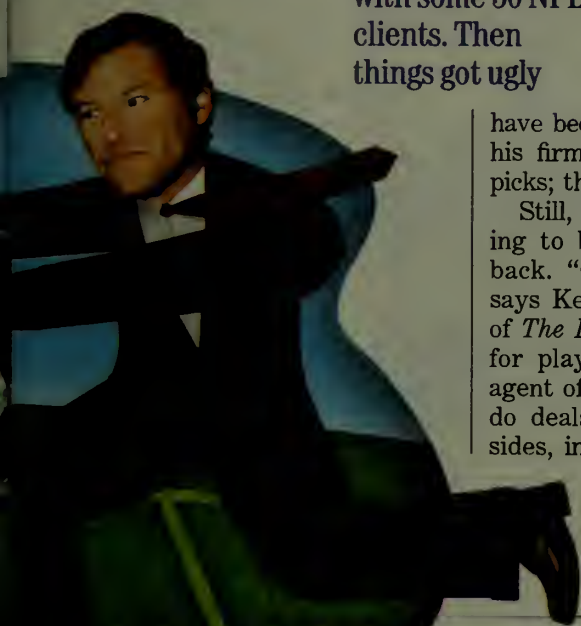
x-year deal for San Francisco 49ers quarterback Steve Young in 1998 and, the following year, a record \$11.25 million signing bonus from the San Diego Chargers for qb Ryan Leaf, a hot prospect who fizzled fast.

Steinberg took in agent Jeff Moorad in 1985, expanding the firm's reach into baseball. In 1999, nine years after joining Steinberg and Moorad, Dunn had his name stenciled on the door, too. Competition from mega-agencies such as Mark McCormack's International Management Group was intensifying, but later in 1999, Steinberg scored a touchdown when Canada's Assante Corp. bought SMD for \$74 million. In court documents, Dunn stated that he left the firm early in 2001 because Assante reneged on a promise to pay him \$2.5 million in stock and because of Steinberg's increasingly destructive antics. At the trial, an Assante lawyer testified that Dunn's stock agreement had not been completed when he left.

Other former Steinberg associates also charged that behind the clean-living facade, the super-agent was a sloppy drinker who seldom serviced clients and whose erratic behavior

END RUN

Dunn (left) exited Steinberg's firm—with some 50 NFL clients. Then things got ugly



Dunn and another agent, Brian Murphy, of threatening blackmail if Steinberg tried to stop them from signing up his clients.

2002 Murphy tells the jury he regret a memo, written a year before he left Steinberg, in which he suggested that Steinberg's

embarrassed them. Buffalo Bills quarterback Drew Bledsoe, who broke with Steinberg last year, testified that his agent showed up at his 1996 wedding "acting as if he was very inebriated.... I had to answer questions from family and friends [wondering], 'Who is that guy?'"

Steinberg's former aides offered similar horror stories. One recalled Steinberg twice licking the faces of women at social events. Leaving another party, the employee said, a blitzed Steinberg, the divorcing father of three, told him: "I want to eat your leg."

Steinberg's friends concede that his drinking became excessive. "He's had a problem in social settings," says Warren Moon, one of a dozen star quarterbacks that Steinberg has represented. Moon, who now works for Steinberg's firm, says his friend has been in rehab and has "taken care" of his drinking problem. In any case, Steinberg's allies contend, his frailties pale in comparison with the transgressions of Dunn & Co.: wooing

dozens of Steinberg's clients, then dishing dirt to justify their treachery (table).

Whatever the outcome of the trial—the case was in the hands of the jury at press time—the split with Dunn has left Steinberg with fewer than 35 players, and new clients

have been slow to sign. Three years ago, his firm landed eight first-round draft picks; this season, just one.

Still, few in the agent world are willing to bet against a Steinberg comeback. "Competitors will throw dirt," says Kenneth L. Shropshire, co-author of *The Business of Sports Agents*. "But for players and families, choosing an agent often comes down to: Can he still do deals? Leigh has done deals." Besides, in the blood-and-guts NFL, being known as a party animal is not the worst thing that could happen to a sports agent.

By Mark Hyman

alleged drinking and womanizing might be used to avoid a lawsuit. "This is probably the most important thing to know about Leigh. He cannot let this go public. Instead, he will have to negotiate a quick settlement with us," Murphy wrote.

NOV. 2002 Buffalo quarterback Drew Bledsoe testifies that at his wedding, "I witnessed Leigh acting as if he was very inebriated... sloppy, dropping food on himself. I had to answer questions from family and friends [wondering], 'Who is that guy?'"

AMD me.

COMMENTARY

By Ronald Grover

BASKETBALL: HOW MUCH IS TOO MUCH?

Why would NBA Commissioner David J. Stern appear on TV in his bathrobe? Perhaps because he's willing to do almost anything to make pro basketball's new, \$4.6 billion TV deal work.

Getting the commish to wait in a bathroom line while Orlando Magic player Tracy McGrady brushes his teeth—the tag line for the commercial is “ESPN: The new home of the NBA”—probably wasn't in the contract. But Stern has reason to be worried. Earlier this year, the NBA shifted most of its national TV games to cable in exchange for the richest contract in pro basketball history. Even for the savvy Stern that represents a major gamble.

The NBA is now the first of the Big Three leagues to hitch its future almost exclusively to the cable and satellite channels that can pay the hefty tab for all those millionaire athletes. NBC bowed out of the bidding after losing \$300 million in the past two years.

In all, TNT and ESPN will air 127 regular-season games and ABC 15. That's in addition to the 800-odd games on Fox Sports telecasts and hundreds more on local television. In other words, wall-to-wall basketball from Oct. 29 until playoffs begin in mid-April.

Can all those games restore the NBA to its high-flying days when Michael Jordan was in his prime?

Maybe, but problems abound. For starters, all hoops, all the time isn't going to help sell seats in arenas. “There's not a lot of evidence that watching games on TV makes people want to go out and pay the 50 bucks to see their local team in person,” says Dennis Howard, marketing professor at the University of Oregon's Warsaw Sports Marketing Center. “And getting people's fan-ies in the seats is still the biggest

source of revenue for most teams.”

“The deal David got is probably the best he could do,” adds New York sports consultant Steve Solomon, a former NHL and ABC Sports executive. “But it isn't network TV, and that's where the eyeballs are.” Despite reaching 90% of U.S. TVs, cable and satellite cater to niche users and are

way courtside as well. “Cable is where TV is going, and we have to go there, too,” says Stern. Perhaps, but cable hasn't exactly been swishing the ball, either: While the NBA's ratings on NBC fell by 34% over the past four years, ratings on TBS and TNT dropped by 29%.

To combat further erosion, the

NBA is creating “must-see” programming. TNT's Thursday night double-header is the only game on the tube. And the old triple-headers on NBC have been replaced by a single ABC contest on

CABLE GUYS: *The NBA's new deal may not help put fans in the seats*

Saturday afternoons.

Still, game-overload is everywhere. Cable operators have so far rejected TNT's demand that they pay extra for NBA games. TNT and ESPN, both of which say they have sold out more than 65% of their ads, had to scale back their initial rate demands. “It's all about supply and demand, and there's plenty of supply,” says media buyer Andrew Donchin of Carat USA. He says he placed Adidas and Kia Motors Co. on TNT without paying the requested increase.

And more national games are on the way. In February, the NBA is expected to begin offering four more games a week on its joint NBA TV venture with AOL Time Warner Inc. The Satellite Dish Network has already

signed on to air them, and DirecTV Inc. is expected to do so, too. That will mean another payday for NBA owners. It may also mean more folks will be joining the commish in forgoing arena seats for a soft couch and a fuzzy robe. And if they doze off, no biggie. There's always another game.

Los Angeles Bureau Chief Grover covers media.



ALL HOOPS, ALL THE TIME

THE NBA'S OLD DEAL WITH NBC AND TURNER SPORTS

Price tag: \$2.46 billion over four years

	GAMES
NBC	33*
TNT	80**
TOTAL	113

*REGULAR SEASON GAMES ONLY

** ON TNT AND TBS

***JOINT VENTURE WITH AOL TIME WARNER, TO LAUNCH IN 2003

THE NBA'S NEW, MOSTLY CABLE DEAL

Price tag: \$4.6 billion over six years

	GAMES
ESPN	75
TNT	52
ABC	15
NBA TV***	96
TOTAL	238

Data: Turner Sports, NBC

less likely to hook the casual fan like a broadcast network that can promote games to up to 20% of the country. In fact, with so many games on the tube, basketball could well become more of a commodity: easily watched and just as easily ignored.

Stern, however, is banking that as folks increasingly desert network TV for *The Sopranos*, *The Osbornes*, and other cable fare, they'll find their

I need to work
from anywhere. Not just
the nearest outlet.

AMD
me.

The mobile **AMD Athlon™ XP** processor helps to extend your notebook's battery life without sacrificing performance. Efficient AMD PowerNow!™ technology lets you work longer from anywhere. And since going mobile rarely means working less, this processor comes loaded with performance. Think desktop-like performance in a laptop package. It's just one more way AMD designs and builds processors for you in mind. We always have. We always will. Ask your IT department about the mobile AMD Athlon XP processor and other AMD innovations or visit www.amd.com

THE CRACKS IN CREDIT SCORING

As loan defaults rise, worries grow about how creditors pick borrowers

Ever since the tech bust in 2000, consumer spending has been keeping the economy afloat. And consumer lending, rather than pay raises or job growth, has been fueling that spending. But now, the techniques that allow profit-hungry lenders to make bigger loans faster, are coming under intense scrutiny. First among them the credit scores that banks, credit-card issuers, and mortgage companies plug into complex mathematical models to figure out how likely borrowers are to repay their loans.

Under the stress of weak growth and rising unemployment, some models are breaking down. Consider Metris Cos., the 10th-largest credit-card issuer in the U.S. On Oct. 28, rating agency Fitch downgraded \$4.2 billion in securities backed by Metris credit-card loans, because charge-offs had increased 30% in the past 12 months, far above expectations. Metris is just one of a half-dozen credit-card companies that announced big jumps in bad loans this year. "These issuers put a lot of trust in their models, and at the end of the day no one really knew how this type of portfolio would perform in a stressed environment," says Fitch analyst Rui Pereira. "Depending on whether or not there is another shoe to fall economically, things could get worse."

Credit-scoring models have become an integral part of the financial system and have been used extensively

since the 1990s. About 70% of the home loans issued since then and nearly all of the \$1.7 trillion in credit-card, auto, and personal loans outstanding were made using a customer's credit score to determine how much to lend and at what interest rate. Credit scoring is also an important tool for investors who buy pools of these loans, because it allows them to evaluate hundreds of loans in minutes.

So far, the problems have been concentrated in credit-card loans to customers with poor credit histories, so-called subprime borrowers. The models underestimated the impact of an economic slowdown on them. "Subprime borrowers are affected disproportionately by economic factors," says Al Brothers, executive vice-president of distressed-debt specialist Cavalry Investments LLC. "They tend to have the highest debt-to-income ratios, and they tend to be the last to get hired and the first to get fired."

Economists fear the problem could spread to \$450 billion of subprime mortgages. As much as 10% of them could go bad, says Douglas G. Duncan, chief economist for the Mortgage Bankers Assn. As a result, investors who buy securities backed by consumer loans are shying away. "There's been a real overreliance on statistics when you're dealing with loans to people," says Gary E. Wendlandt, chairman and CEO of New York Life Investment Management LLC.

FLAWED MATH?

Consumer lenders lean heavily on credit scores to price loans and weed out undesirable borrowers. That's proving dangerous in some cases. Here's why:

SHORT HISTORY Most credit-scoring models use data going back only two years.

BAD DATA Credit-report data used in the models are sometimes inaccurate.

SCORE POLISHING A cottage industry has emerged, dedicated to helping borrowers improve scores by rearranging finances.

DISCRIMINATION POTENTIAL Critics say scoring unfairly steers minorities into higher-priced loans. A recent suit alleging that Fannie Mae's scoring system is unfair has prompted regulatory scrutiny.

Data: BusinessWeek



Regulators are getting worried about credit scoring, especially the way it has been used to pump up lending. The amount of subprime loans outstanding has doubled to \$500 billion in the past three years as some lenders chased higher fees and interest rates that can yield profits five times those of conventional loans. "Even before we got into an economic slowdown, these lenders were pushing rapid growth through ambitious business models," says George French, deputy director at the Federal Deposit Insurance Corp. To get a clearer picture, bank regulators may require consumer lenders to break out subprime loans by next March.



Consumers who increasingly game the system further undermine the reliability of the scores. With more riding on credit scores than before, a cottage industry has sprung up dedicated to helping would-be borrowers improve their ratings to get lower interest rates.

There are few checks on the accuracy of the data. Three credit bureaus, Experian Information Solutions, Equifax, and Trans Union, each keep accounts on 190 million customers and collect about 16 billion pieces of information annually in the U.S. They then sell it to lenders or third parties, who use it to create a credit score. But the information may be incomplete because lenders aren't required to report consumer data to the bureaus. Furthermore, the bureaus don't check the information unless consumers complain. The industry hasn't monitored what percentage of data overall may be flawed, says Norm Magnuson, vice-president at the Consumer Data Industry Assn., a trade group. But a recent study found that fewer than 1% of customers were denied credit as a result of errors, he says.

Americans, and 34% of Hispanics did. The Housing & Urban Development Dept., which regulates fair lending, is reviewing Freddie's and Fannie's underwriting practices, a spokeswoman said, but results are not yet available. A Fannie Mae spokeswoman says that the company plans to formally respond to the suit on Nov. 18, adding that it is in full compliance of all fair lending laws, and that its programs have expanded minority homeownership.

Until recently, the scores drew the most criticism for being opaque. But under pressure from consumer advocates, Fair, Isaac & Co. of San Rafael, Calif., which produces the most widely used scores, called FICO for short, released some details about its secret formula in 2000. About 35% of a FICO is based on a borrower's history of paying back debt; 30% on how much of the credit available a borrower has used; 15% on the length of the borrower's credit history; and 10% each on type of credit and pattern of credit use. FICO scores generally fall between 550 and 800, but nearly 20% of the U.S. population has a credit score under 620, generally the cutoff for a prime-rate loan.

Founded by engineer William Fair and mathematician Earl Isaac in 1954 to provide credit advice to lenders, the company stoutly defends its role as a key player in the industry. Lenders should be using many other factors to make decisions, says Michael W. Rapaport, vice-president at Fair Isaac. For instance, they should be monitoring their portfolios

The scoring models failed to predict how badly a slowing economy would hurt customers with poor financial histories

Questions are growing about the numbers backing the scores. In an Oct. 7 speech, Federal Reserve Chairman Alan Greenspan voiced his concerns that problems may arise from an "insufficiently long data series." Most credit-scoring models rely on two years of data. That meant the models produced rosy forecasts in the long economic boom of the 1990s. But as debt mounted, and the recession hit, losses exceeded levels suggested by the models. "When you place much hope on past experiences, you're setting yourself up for trouble," says the FDIC's French. Adds New York Times's Wendlandt: "We didn't even have credit-card lending 30 years ago."

The biggest problem, according to some critics, is that the credit models are racially biased and unfairly drive minority borrowers into high-rate loans. A suit filed in U.S. District Court for the District of Columbia on Sept. 13 accuses Fannie Mae, the government-sponsored housing agency, of discriminatory lending practices. Safiyyah Rahmaan, an African American, allegedly was denied a 6.5% mortgage loan after Fannie Mae's automated underwriting process said her credit score was too low. The suit says Fannie's scoring process is biased and cites a Freddie Mac study that found that while 27% of Caucasians had "bad" credit records, 48% of African

regularly and readjusting rates and loan size as a borrower's situation changes. "If you're going downmarket, it's even more important to track and monitor your portfolio closely," he says.

Loans have been made to customers with poor credit histories or low incomes for decades. Hardscrabble finance companies such as United Cos. and the Money Store did so successfully by knowing their customers well. All have either been bought out or closed in the past five years as competition increased from banks that can borrow money more cheaply. At least the old-timers weren't tripped up by fuzzy math.

By Heather Timmons in New York

MUTUAL FUNDS

VANGUARD'S EMBARRASSMENT OF RICHES AND RISK

Despite its warnings, customers keep piling into bonds

Vanguard Chairman and Chief Executive John J. Brennan couldn't resist interrupting. As he does routinely, Brennan was listening in on customer calls one day in early October. A woman in her late 30s wanted to move all of her 401(k) money from equities into bond funds. Taking over from the Vanguard rep, Brennan asked her why. Did she know she could lose money on bonds? No. In 15 minutes, Brennan persuaded her to keep her money where it was. "It's a classic example of a young person capitulating on stocks," he frets. "People are moving emotionally toward bonds."

The incident encapsulates Valley Forge (Pa.)-based Vanguard's dilemma. Almost three years into a fierce bear market for stocks, the bond rush is manna from heaven for the largest U.S. mutual-fund company. Investors poured \$34 billion net of withdrawals into Vanguard Group Inc. funds in the first nine months of 2002—two-thirds of it into bond funds, according to Boston-based Financial Research Corp. If the trend holds, Vanguard will draw in more new funds than any other fund family this year—the sixth time in the past seven years.

Yet Brennan fears the flight to bond funds could easily end in tears for some investors. "It's no different than stocks in 1999," he says. "The risk is disappointment and surprise.... I hate having an investor get surprised." It's not an idle concern: A recent Vanguard poll showed that 70% of respondents didn't know that if interest rates rise, bond prices fall, and vice versa. So the firm's

BUBBLE?

A bond bust could hurt CEO Brennan's plans for the mutual-fund giant



Web site now warns of "irrational exuberance" in bonds. In a personal posting, Brennan cautions that investors who have moved entirely into bonds since March, 2000, are "investing by looking in a rearview mirror, and...probably moved to bonds too late to get the returns they were seeking."

A bond shock to investor confidence could also deal a setback to Brennan. "[It] could hurt [Vanguard's] image, its

reputation, and its relationship with clients," says William Dougherty, president of investment adviser Kanon Bloch Carre. That's because Brennan wants to deepen Vanguard's ties to customers by broadening its services without losing what most appeals to its investors—its low-cost, low-hype style. Vanguard funds

charge an average of 0.3% of assets, 0.99% for Fidelity Investments, according to Morningstar data, because fund customers—who want low fees—overwhelm the company.

Brennan needs happy customers since his goal is to make Vanguard their main financial-services company. He has wrestled with expansion since 1996, when he took over as CEO from Vanguard founder John C. Bogle, the high priest of low-cost index investing. Brennan has

built up the company's 401(k) management business and expanded Vanguard's offerings to include a series of exchange-traded funds in 2001—much to the chagrin of Bogle, who believes they encourage unnecessary trading.

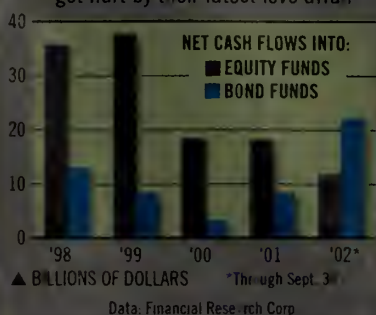
It's been a slow process. In May, Brennan shelved plans for a high-fee private-equity fund for wealthy investors after failing to raise enough money. It wasn't until October that Vanguard rolled out a cash-management account that gives investors who have \$250,000 or more at Vanguard free checking and a Visa gold check card, a high-end debit card. Brennan says his next big push will be to improve Vanguard's limited financial planning and advice options. "People who come to us for advice bring us a lot more assets," Brennan says.

Right now, Vanguard is sitting pretty—and not just because it's cheap. After all, other discount financial-service companies, such as online broker Ameritrade Holding Corp. (page 140), are struggling with low volumes. The big difference is that Vanguard still has a significant reservoir of customer goodwill because it didn't hype its business and tried to contain investors' expectations during the boom. That's why Vanguard equity funds still had \$12 billion in net inflows this year through September, down from \$13 billion in the same period last year, but in marked contrast to the billions flowing out of many funds. "This type of environment is perfect for Vanguard," says Daniel P. Wiener, editor of newsletter *Independent Adviser for Vanguard Investors*. The question for Brennan is whether it will be too much of a good thing.

By Amy Barrett in Valley Forge, Pa.

THE BOND RUSH

Vanguard execs worry that investors may get hurt by their latest love affair



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ONLINE BROKERS

ONE TOUGH TRADER

How Ameritrade, moribund a year ago, sprang back to health



Why is Ameritrade Holding Corp. Chief Executive Joseph H. Moglia so peppy? There couldn't be a worse time to be an online stockbroker. Do-it-yourself investors who made Web trading a national sport are hibernating. Online trading this year through October is down 35% from the same period of 2001. And Ameritrade lost a net \$29 million in its fiscal year ended Sept. 27 on an 11% drop in revenues.

Yet Moglia, 53, is undeterred. In September, he completed Ameritrade's \$1.3 billion, all-stock purchase of Datek Online Holdings Corp., the leading venue for day traders, boosting Ameritrade's accounts by 80,000, to 3 million. On Oct. 22, he launched a \$115 million ad campaign to win back investors. "Now that we've established ourselves as the largest online broker, you are just beginning to see our potential," he boasts.

Ameritrade may be big online, but it's still a small fry in the securities world. That's why the smart money isn't betting on a solo future for Ameritrade long-term. Plenty of signs point to a sale when markets turn up. First, the Datek deal cut the holdings of the company's reclusive founder and chairman, J. Joe Ricketts, to 28% from 55%. It also gave board seats and 30% of the

stock to three private equity firms: Bain Capital, TA Associates, and Silver Lake Partners, which eventually will sell to return profits to their investors. The change pleases other shareholders. "It was always a concern with Ricketts' control, whether he would be willing to sell," says one portfolio manager, who owns the shares.

Even Ricketts, 61, now seems game. Semi-retired, he mostly raises bison on his ranch in Jackson Hole, Wyo., and rides a motorbike around the country with friends. Still, he denies a sale is imminent. "There isn't any question in my mind that selling out today will be the wrong thing for shareholders," Ricketts insists in a rare interview at the company headquarters in Omaha.

Analysts say Ameritrade would make a good catch for American Express, American International Group, or Bank of America. And its singular focus on online trading—in contrast to rival E*Trade Group Inc., which embraced other financial services—could whet a potential acquirer's interest. "The company has very little baggage," says Morn-

AMERITRADE

Chairman Ricketts says selling out now would be "the wrong thing for shareholders"

ingstar analyst Rachel Barna

Thanks to Moglia, Ameritrade now looks as if it can survive even make money until a buy comes knocking. A year ago, the company was given up for dead after losing \$91 million. Moglia hired from Merrill Lynch & Co. in March, 2001, slashed expenses 13%. He cut bank debt to zero from \$17 million and converted debt by 75%, to \$48 million. In July, 2001, before persuading Datek to sell, Moglia snapped National Discount Brokers Co. from Deutsche Bank. Customer assets now total \$34 billion, \$26 billion a year ago. So Ameritrade's pain threshold is now pretty high, the CEO says: If the average number of daily trades falls 65%, to 50,000, from 140,000 a day, it could still break even. Analysts expect net profits in 2002 the first time since 1999.

The owners are in no hurry to sell, with Ameritrade's stock priced at \$4.50, down around 30% for the year. Says C. Kevin Landry, CEO of TA Associates and an Ameritrade board member: "We want to participate in the upside."

That upside isn't guaranteed. It may take at least a year to integrate Datek customers, who shunned Ameritrade in the past, could jump. E*Trade, which offers banking and mortgages, could also take business. Moglia argues that Ameritrade's superior technology and customer service will win out. The evidence? Ameritrade's 46% growth in accounts in the past two years (plus Datek), vs. 21% for E*Trade and 8% for TD Waterhouse Group Inc. Also, argues, Ameritrade customers trade 10 times a year on average, vs. 8 for the rest of the industry.

Moglia has surprised a pessimistic Wall Street several times. When he bought Datek, the skinny was that Ameritrade would go on the block fast. That hasn't happened yet, but it may be just a matter of time—and timing.

By Pallavi Gogoi in Omaha

MATCHMAKER, ANYONE?

Signs point to a sale of Ameritrade when the market picks up:

Data: BusinessWeek, Ameritrade Inc.

ALL GUSSIED UP

Ameritrade bought rival Datek for \$1.3 billion, paid down all its bank debt, and bought back 75% of its convertible bonds. Operating margins are now the highest of the online brokerages.

NO BAGGAGE

Online trading is down 35% this year, with no upturn in sight. But as a pure online broker, Ameritrade would appeal to financial-services giants that want to expand into that business.

HUNGRY INVESTORS

Private equity funds that sold Datek ended up with 30% of Ameritrade's shares. They're sure to seek an exit strategy. But not till prices rise.

A large pink elephant is superimposed over a background image of a business meeting. The elephant's head and trunk are in the foreground, while several business professionals are seated around a conference table in the background, looking towards the elephant.

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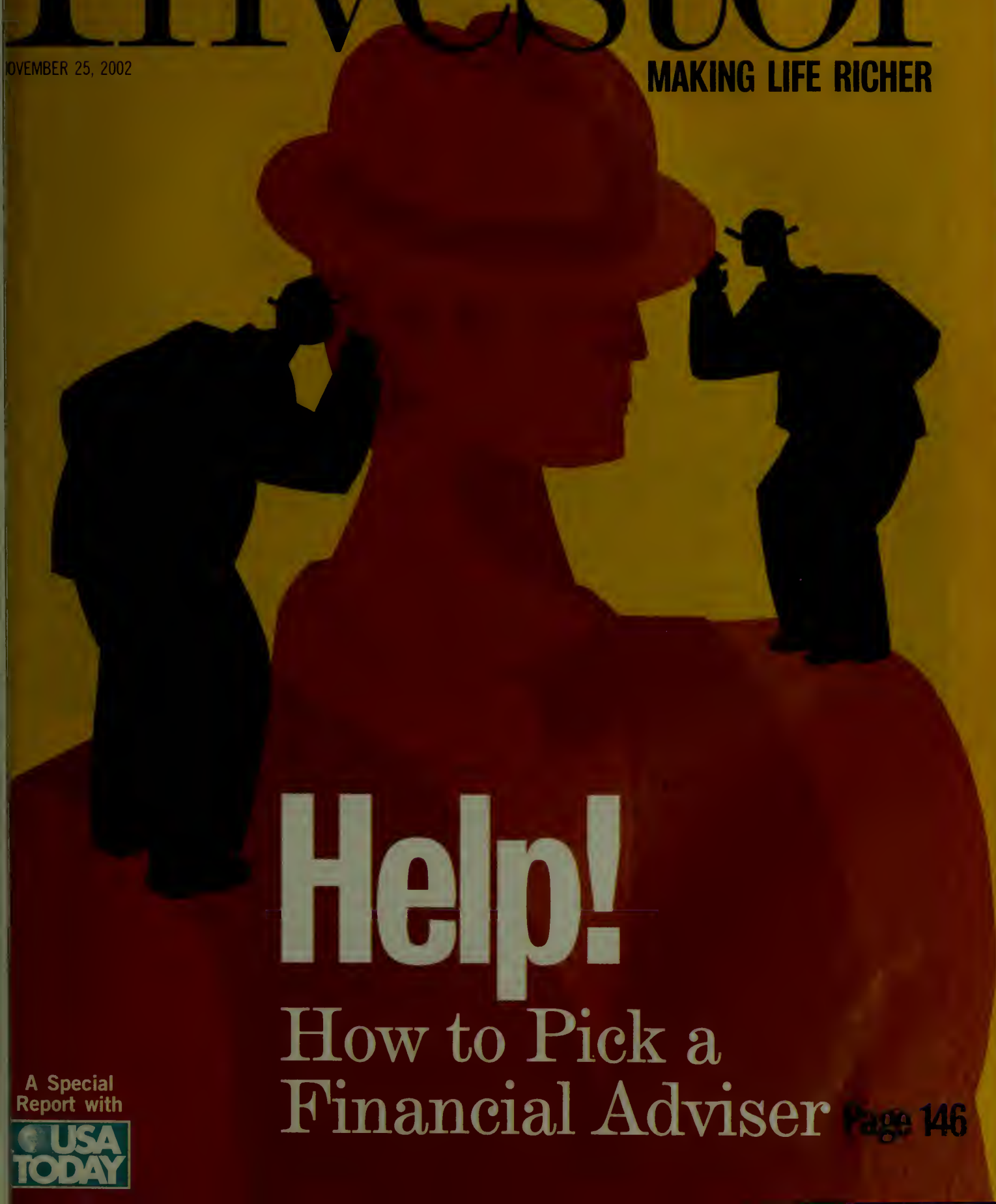
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BusinessWeek

Investor

NOVEMBER 25, 2002

MAKING LIFE RICHER



Help!

How to Pick a
Financial Adviser **Page 146**

A Special
Report with

**USA
TODAY**



**One woman changed the face of American surgery.
Surely all of us working together can keep healthcare affordable.**

Helen Octavia Dickens, M.D. first black woman to become a Fellow of the American College of Surgeons

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EDITED BY
TODDI GUTNER

THE STAT

63

PERCENT of Americans said they don't feel the nation's financial, government, or regulatory systems protect people against investment abuses and accounting fraud.

Financial Planning Assn.

GOLF

THE ZAGAT'S BREAK PAR

Golfers galore rate courses in this new book

From the publishers of the famed Zagat restaurant guides, comes **AMERICA'S TOP GOLF COURSES** for 2003. Here are some of the folksy comments from its 5,311 volunteer golfer/reviewers:

INTERNATIONAL LINKS, MI. Sure, "it's in the flight of Miami International port," and yes, "you see for highways as you golf," "for a quick round" before plane takes off, "you 't beat" it.

EAT RIVER, MILFORD, MN. You're in for either "championship-level" "y to remember" or a "tt-kicking," so "bring A-game or your depressants."



MUTUAL FUNDS

Bruised by Bonds

AFTER 12 CONSECUTIVE years of positive returns, the **Merger Fund** has stumbled in 2002, falling 7.7% as of Nov. 11. What happened? With deals at an eight-year low, the fund's managers could not find enough arbitrage opportunities. So they bought corporate bonds. That's allowed, but it's not the fund's expertise. Bonds make up 18% of the \$850 million portfolio.

Many of the bonds' issuers read like a bankruptcy court docket: WorldCom, Enron, Adelphia Communications. Only the Adelphia bonds were distressed when manager Frederick Green bought them. WorldCom's were investment grade. "Absent the fraud revelation, they would've paid off, because they had very short maturities," says Green. The Enron bonds were purchased when the energy trader was a Dynegy acquisition target.

Merger Fund's decline has ticked off a lot of investors, who relied on the fund as a hedge against the bear market. **One angry shareholder** at a Morningstar.com message board summed up the mood: "Totally pathetic management buying this crap."

Lewis Braham



STOCKS

BUSH BETS

Want to profit from the GOP sweep? Consider these stock picks from ChangeWave Research of Potomac, Md.

■ **STARBUCKS (SBUX)** We'll be up late watching the war on TV, so we'll need coffee.

■ **GUIDANT (GDT)** A Guidant defibrillator is a must for keeping Dick Cheney alive at Bush's major meetings.

■ **EON LABORATORIES (ELAB)** If the GOP passes a Medicare prescription plan, Eon's generic drugs will benefit. *Mara Der Hovanesian*

COOKING

FROM ICE TO FIRE

A marriage of opposites: Whirlpool's \$1,799 **Polara refrigerator/oven** keeps the turkey cold until it's ready to roast. Then the oven turns on for a preset time. If the

meat is done before you get home, the oven will switch to warm before reverting back to refrigerator mode. *Michael Arndt*



ILLUSTRATION BY LUBA LUKOVA. PHOTOGRAPH BY RICHARD CARSON/REUTERS (BUSH & CHENEY)

Which Adviser Knows The Way?

Almost anyone can hang out a shingle. Here's how to search out the right guide for you **BY LEWIS BRAHAM**

IF THE MEDICAL PROFESSION WERE as loosely defined as the financial advice business, witch doctors would share the same page in the phone book as brain surgeons. Remember that if you are thinking about hiring an adviser to heal your financial wounds.

Almost anyone can claim to be a financial planner or investment adviser. There are a myriad of credentials an adviser can appropriate, some familiar and others obscure. Policing the business is problematic, with oversight split between federal and state regulators—and a chasm between the two.

That's why *BusinessWeek*, in partnership with *USA Today*, is bringing you a special report on how to select a financial adviser. We'll sort out the different kinds of advisers, looking at their



HELP ME A survey of 400 financial advisers found that new clients came to them for a multitude of reasons

Data: Cerulli Associates

50%
Retirement
needs

46%
Bad experier
previous a



educational backgrounds, services, and fees—and give you a list of questions to ask when searching for someone to hire. We'll also lay out how regulators keep tabs on advisers and examine some of the scams the more unethical ones have perpetrated.

Many investors haven't been happy with their experiences with advisers. Look at a report by Cerulli Associates, a financial services consulting firm, which surveyed 400 advisers asking them why their new clients came to them. Nearly half of them came because of a "bad experience with a previous adviser." That's twice as many as the number of clients who sought advice because of poor performance managing their own portfolios.

FEE STRUCTURE

Some of the dissatisfaction with advisers arises over compensation. The traditional model is the commission-based adviser, who is paid when you make an investment. That method is being supplanted by the fee-based model, in which the adviser receives a combination of commissions and fees. This way, the adviser has less incentive to churn the portfolio or make trades just to generate more commissions. The third approach is "fee only." That's when clients pay an annual fee, either an hourly rate or a percentage of assets under management.

If you're looking for an adviser for the first time—or thinking of replacing the one you have—you need to figure out how much and what kind of advice you need. If all you want are some suggestions on how to allocate your IRA or improve your portfolio performance, you could get that through Charles Schwab or Fidelity Brokerage Services for a nominal fee of about \$250.

But there's much more to your financial well-being than your stocks and bonds. Do you have a debt management problem? Can you rearrange your finances to lower taxes? Do you have enough insurance, and is your estate in order? All of these demand different areas of expertise and may require that you find someone with a certain type of credential.

What about credentials? Certified Fi-

DUE DILIGENCE

BEFORE YOU DO ANY HIRING, ASK THESE QUESTIONS

- What are your **credentials**, experience, and areas of expertise?
- How are you **compensated**?
- Will you provide a comprehensive **financial plan** or just portfolio advice?
- What type of **clients** do you serve?
- Can you give me **references** from other clients?
- Will you be my **fiduciary**?
- Have you ever been publicly **disciplined** for any unlawful or unethical action?
- Can I get a written **agreement** detailing fees, fiduciary oath, and services to be provided?
- How often will you **review** my financial plan or portfolio with me?
- Are you a **member** of any financial planning or adviser organization?

23%

or performance
on own

13%

Inheritance
needs

4%

College savings
needs

4%

Market
research

3%

Tax
issues

financial Planner is the most recognized designation. CFPs have comprehensive educational training and must pass a 10-hour certification exam and have at least three years' experience as a financial planner before qualifying. "From my perspective, the CFP mark is the cornerstone of financial planning," says Guy Cumbie, chair of the Financial Planning Assn., whose members sport numerous designations (table).

THE RIGHT STUFF

Other credentials are narrower in scope. The Chartered Financial Consultant (ChFC) is primarily for insurance agents, and Chartered Financial Analyst (CFA) for securities analysts. They may be experts in their specific fields but lack the broader knowledge to develop and monitor comprehensive financial plans. They may also have biases toward certain investment solutions. "In the ChFC textbooks, you see a lot of problems as being solved by life insurance or annuities," says Robert Moody, an Atlanta adviser who has both the CFP and ChFC credentials. "The CFP textbooks don't have that bias."

Some advisers question if even CFP designees are sufficiently educated. "The CFP credential is the best for financial planning, but it's like an undergraduate degree," says Louis Stanasolovich, a Pittsburgh adviser and CFP. "It's not a doctoral-level program." So also look for advisers with other designations: a CFA if you're most con-

What the Titles Mean

CREDENTIAL

Chartered Financial Analyst
CFA

Certified Financial Planner
CFP

Certified Investment Management Consultant CIMC

Certified Public Accountant
CPA

Certified Trust & Financial Advisor
CTFA

Chartered Financial Consultant
ChFC

Chartered Life Underwriter
CLU

General Securities Representative
GSR

Personal Financial Specialist
PFS

COMMENTS

Good for securities analysis but not necessarily for comprehensive financial planning

Requires a comprehensive education in financial planning

Training focuses on finding good mutual funds and money managers

Accounting degree, best with PFS designation for comprehensive planning

Estate planning and trusts expertise, common in the banking industry

Financial planning designation for insurance agents

Insurance agent designation, often goes with ChFC credential

A registered representative—a broker—trained only in investment products

Less common but as comprehensive as CFP—for CPAs only

tried to play down the role, calling their reps "financial advisers" or "financial consultants" and emphasizing fees instead of trading commissions. Merrill Lynch puts all new brokers (what it calls "Financial Advisors") through a five-year probation that includes earning a Certified Financial Planner designation. "We cover trust estate planning, cash management, lending, and a range of plans that deal with investments," says James Gorman, president of Merrill Lynch's U.S. Private Client Group. "We are light years away from the age of securities and bonds." Still, 1,000 of Merrill's 13,400 Financial Advisors have earned the mark.

Whatever letters follow their names, advisers must treat you fairly and recommend investments that are suitable for your financial circumstances. That applies to everyone who sells securities whether or not they're a registered investment adviser. "Fair dealing means treating the clients and the employer's interest equally," says Cumbie. Advisers serve as fiduciaries must answer to a higher standard and put the client's best

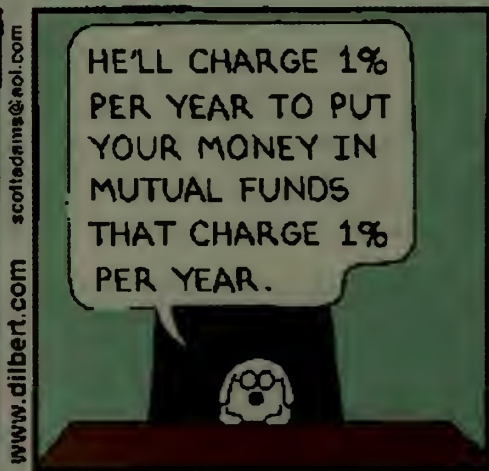
interest ahead of the firm's.

If you're interviewing prospective advisers, be sure to ask if they will act as fiduciaries. The best advisers take a holistic approach—not just looking for a fee or commission on client investable assets but also examining every aspect of their finances. "We

cerned about stock picking; a certified public accountant (CPA) degree if taxes are important; a chartered life underwriter (CLU) credential if insurance advice is essential.

BROKERS OR ADVISERS?

The big Wall Street firms have for years



couple of condominiums here and there and a vacation home in Ohio," says Andrew Horn, a purchasing manager for a restaurant chain in Dublin, Ohio. "Our adviser includes them as assets in our financial plan, though he is compensated by managing them."

CONFLICTING LOYALTIES

Need, if an adviser is not getting your complete financial picture, you may have a lot of experience. Any good adviser should not only ask you about your financial goals and risk tolerance but also examine all your assets and liabilities. What's the cost of carrying credit-card debt at 15% on your portfolio may be earning single-digit returns? Still, Cerulli's research found that only 29% of advisers examine every client's debt level.

Even more shocking, the same research found that only 27% of advisers practiced comprehensive financial planning. The reason those numbers are so low has everything to do with compensation. "Most advisers who work for brokerage firms are paid on commission on the products they sell and a percentage of the assets they manage," says Rachael Malatesta, a senior analyst at Cerulli Associates. "They don't get paid for managing the liability side of a client's balance sheet."

Such fee-based advisers have conflicting loyalties. As "registered representatives" of the brokerage, their job is to sell products and services. They're supposed to act in the client's best interest. But sometimes what's best for the firm may not be what's best for the client. For instance, many fee-based advisers don't sell low-cost mutual funds offered by firms such as Vanguard and TIAA-CREF because they don't compensate the salesperson.

You'll have a better chance of getting objective advice from "fee-only" financial planners, who avoid possible conflicts of interest by accepting payment only from clients. The National Association of Personal Financial Advisors (nafpa.org) represents about 800 such advisers nationwide. What keeps people away from fee-only professionals is that many such advisers won't take a client who doesn't have several hundred thousand dollars to turn over. That is an expense, but some will also work on an hourly rate.

The irony is that most people seek advisers to relieve the burden of managing their finances themselves. But it's the burden in itself to make sure you've found the right adviser.

With Amy Borrus in Washington

When the Going Gets Tough...

... Many turn to financial counselors. **BY SANDRA BLOCK**

USA Today



divorce

penses, says Barbara Raasch, a personal financial specialist at Ernst & Young.

Many divorcing couples underestimate how much more money it costs to support two separate households. Unless you're extremely well off, you may have to make changes in your lifestyle. Raasch suggests consulting a planner even before filing for divorce. "As awful as this might sound, if you see a potential for divorce, you want to prepare yourself as much as you can for it," she says.

A LIFE-CHANGING event is often the stimulus that drives people to seek financial advice. While most will do better if they start their planning before a catastrophe or major change occurs, "I would say 60% to 70% of the people I see for the first time are driven to my doorstep by one event or another," says David Berman, a certified financial planner (CFP) in Baltimore.

What are the major life events that motivate people to solicit help?

DIVORCE

Dividing a household can create economic havoc. Making matters worse, "everybody's terrified," says Mary Vanderhaar, a CFP who specializes in divorce.

A good financial planner can help you figure out your net worth, expenses, and long-term financial needs—all critical components of an equitable settlement. Too often, divorce settlements focus on the spouses' income, instead of their living ex-

DEATH OF A SPOUSE

Psychologists rank a spouse's death as life's most stressful experience. In the midst of all your grief, you may also find yourself dealing with a large amount of money—from life insurance, retirement plans, and investments, says Mitchell Freedman, a personal financial specialist in Sherman Oaks, Calif.

A good adviser can help you use that money to provide financial security. While many of his clients want to leave an inheritance for their children,



death of a spouse



a financial windfall

Freedman encourages them to focus on their own needs first.

FINANCIAL WINDFALL

If you win the lottery, inherit a large sum, or bag a legal settlement, you'll face tax and estate-planning issues. Judith Lau, a Wilmington (Del.) CFP, recommends that clients stash their windfalls in a low-risk money-market

stock tips, insurance offers, and proposed business ventures. Lau advises clients to tell friends and family to send their investment ideas to her. It's more diplomatic than telling them they're a poor credit risk, she says.

CAREER CHANGE

In the past few months, Bob Bilkie, a Chartered Financial Analyst in Southfield, Mich., has talked to quite a number of people who want to get off the corporate treadmill, a trend that he attributes

In stressful times, it can make sense to stash funds in a money-market fund, rather than acting too quickly

fund until they've mapped out a plan. "One of the most common mistakes is to do things too quickly," Lau says.

A financial planner can also help you deal with bad advice. Windfall recipients are inundated with

to last year's September 11 terrorist attacks. The recession has also forced many workers to make adjustments. Some are offered buyouts. Others are laid off or take early retirement.

Bilkie says most people have only a vague idea of how much they spend. That information is critical to determining whether they can afford to reduce their hours, switch to a lower-paying job, or stop working altogether.

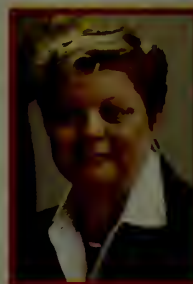
The news isn't always bad. Bilkie advised an occupational therapist who loathed his boss. After completing a long-term analysis of the client's savings and estimated investment returns, Bilkie told him he could afford to retire. Six months later, the client was still working. The reason? Once he knew he could afford to quit, working for his unpleasant boss didn't bother him as much.



career change

Q&A

ADVICE FROM A SEASONED PRO



Deena Katz, a 20-year veteran of financial planning and president of Evensky, Brown, Katz in Coral Gables, Fla., has some good advice about seeking help.

She recently spoke with Associate Editor Toddi Gutner.

Q: How can the consumer and the planner establish trust?

A: Most planners will spend an hour or two in the first meeting at no charge. They'll talk about what they do, how they work, and ask questions about the client's circumstances. The planner, like the client, is looking for a good fit. The two should spend enough time together to develop a feeling of trust. The client should ask questions—how the planner is paid and what is the planner's philosophy. It's like finding a doctor. If the doctor thinks similarly, then a patient is more likely to tell him or her very personal information.

Q: Which financial-planning credentials matter most?

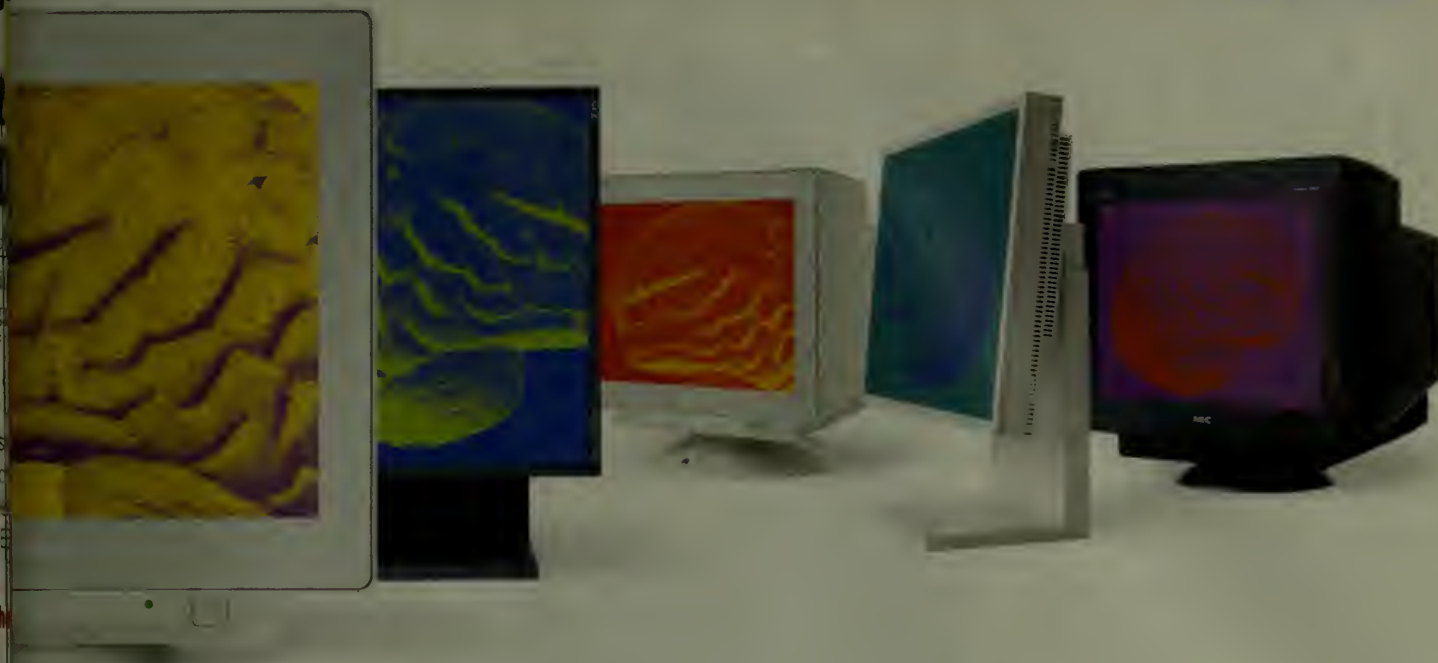
A: Anyone with a crayon and cardboard can call themselves a financial planner. There are so many designations, it's like an alphabet soup. The only one that requires rigorous schooling and testing is the Certified Financial Planner (CFP) designation. Unlike other designations, the license can be revoked by an ethical oversight committee, the CFP Board of Standards if the planner has breached the code of conduct. So clients know that if they have a problem, their financial professional will be held accountable.

Q: What's the difference between financial planning and investment advice?

A: Financial planning looks at your entire financial life—retirement, insurance, budget, college education, and more. Investment advice is just those decisions that focus specifically on your investing strategies.



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The Flimflam Du Jour

Here are the con artists' latest schemes.

BY CHRISTINE DUGAS

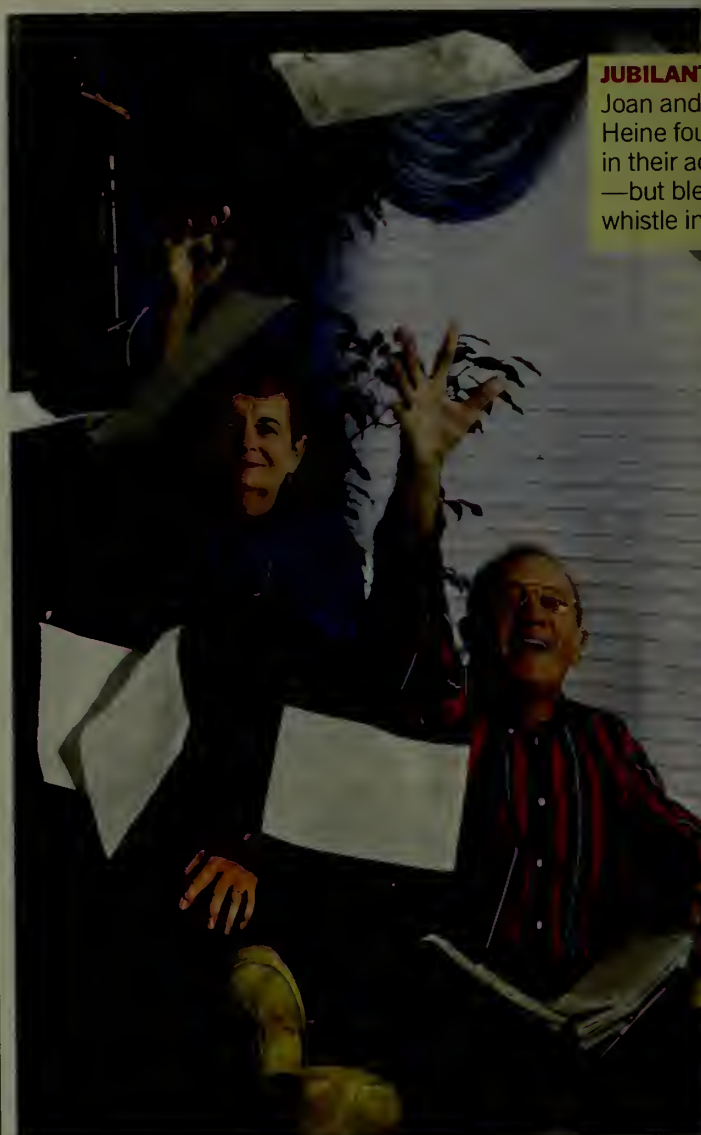
USA Today

REGULATORS SAY thousands of investors, burned by the long bear market and low rates of return on bank deposits, are falling prey to investment advisers who purport to offer low-risk, high-return investments. What they often get is no return on capital and no return of their capital.

What kinds of deals are they plying? ■ **PROMISSORY NOTES** These short-term corporate-debt instruments sold by insurance agents and financial planners sport double-digit interest rates and appeal to income-starved investors.

The problem is, these are unregistered investments: The companies issuing them don't file financial reports with the Securities & Exchange Commission. And those issuers are either very risky or even nonexistent. Defrauded investors have also learned that even if the money is being held at a reputable bank, they have no assurance the company itself is solid.

■ **PRIME BANK SCHEMES** Unscrupulous advisers offer "secret" prime bank notes that promise triple-digit returns. The secret of the high yields, they're told, is that the money is invested by overseas banks. "The pitch is that the money is going overseas, and so there are no taxes," says Mark Sendrow, director of the securities division at the Arizona Corporation Commission. Such



JUBILANT:

Joan and Jack Heine found gaps in their account—but blew the whistle in time

from such investments may be phoned off by sales charges. Sometimes, the equipment company announces that the deal is not working out and terminates the lease. Regular investors say the kiosk investor received some but not all of payments—and the case is pending.

What all these frauds have in common is that the investment is uncommon. Run the way if the plan promises a "guaranteed" high return. Many of those bills of their funds may have avoided the situation if they had taken the time

to check the adviser's credentials and disciplinary record.

■ **EQUIPMENT LEASING** Thousands of investors have been scammed by people selling interests in pay phones, automated teller machines, or Internet kiosks, according to the North American Securities Administrators Assn. The way it works: A middleman—sometimes an investment adviser—offers investors the chance to own a pay phone, promising it will generate a high return with little or no risk. The equipment company agrees to lease it back and service the equipment for a fee.

The promised returns may be unrealistically high. One North Carolina investor was promised a 17% return on the \$25,000 he paid for an Internet kiosk, according to state securities regulators. Much of the income

check the adviser's credentials and disciplinary record.

Above all, if you run into problems, find a discrepancy in your account statements, call your planner immediately. If you don't get a satisfactory response, go to the supervisor, and finally to your state securities regulator. If you hang back to see how the investment plays out, it will be presumed you accepted it," says Barbara Roper, director of investor protection at the Consumer Federation of America.

That was critical for Jack and Joan Heine of Amherst, N.Y. When Jack, a retired electrical engineer, discovered \$75,000 missing from an account controlled by his financial planner, he got in touch with law-enforcement authorities. "You want to stop the fraud while there are still some assets left to recover," says Roper. Heine, with the help of the New York attorney general's office, was able to recover his money. Most cases don't have such a happy ending.

Burned by the bear market, investors are falling prey to hucksters who offer investment deals too good to be true



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Look Before You Listen

It pays to know how financial consultants are regulated.

BY AMY BORRUS

LAST YEAR, DALE Prappas and John Williams, a Seattle couple who are partners in a boiler-inspection business, attended an investment seminar for seniors and liked what they heard. The host, financial adviser Jay D. Kaiser, "talked about protecting your money against Medicaid if you get sick, and how his mother had influenced his decision to get into the investment business," recalls Prappas, 57. Weeks later, she and Williams, 81, paid Kaiser \$650 to manage their nest eggs.

At their first consultation, Kaiser recommended that Williams buy a fixed annuity to replace the variable one he had previously purchased. "It had a guaranteed interest rate," Williams recalls. "It sounded great." But switching out of the old annuity would cost him \$20,000 in surrender charges, warned another adviser, who managed the account in which the old annuity was held. Even more astonishing, Kaiser wasn't an investment adviser at all, but an insurance agent who would pocket a big commission on the new annuity.

Fortunately for Williams and Prappas, the other adviser was able to cancel the transaction, and he notified state securities regulators. Kaiser ultimately paid \$8,150 in fines for acting as an ad-

viser even though he wasn't registered. The Seattle couple could have saved themselves some heartache if they had known that, under Washington state law, advisory firms must register with the state securities division. A simple Internet search or phone call would have revealed that Kaiser wasn't licensed to give investment advice.

When shopping for financial advice, it pays to know how advisers are regulated. The rules can provide a map to a firm's or individual's credentials, fees, duties, and disciplinary record. Financial advice-givers answer to a hodgepodge of rules, and enforcement isn't uniform.

DIVIDED DUTIES

Anyone in the business of advising others about securities for a fee is governed by the Investment Advisers Act of 1940. But oversight is split between the Securities & Exchange Commission, which oversees large firms, and the states, which look after small outfits and individual advisers.

And there are plenty of exemptions. Legally, brokers who offer investment advice but don't receive any special compensation for it adhere to broker-dealer regulations. But in practice, even most brokers who offer advice for a flat fee instead of commissions are governed

KEEPING TABS ON ADVISERS

People or firms offering advice about securities for a fee are regulated as investment advisers.

■ WHO HAS OVERSIGHT

Investment adviser firms that manage \$25 million or more must register with the Securities & Exchange Commission. Smaller firms and individual reps are licensed by states.

■ HOW ADVISERS REGISTER

The SEC and the states require advisers to file a uniform registration form ADV giving details about the types of services offered, fees, methods of analysis, and any trouble they've had with regulators. Investors can get ADVs on the SEC's Web site or by calling state regulators.

■ WHO QUALIFIES

The SEC doesn't require investment advisers to take a test. But nearly all states require them to pass a three-hour exam.

■ ADVISERS' STANDARDS

Investment advisers have a fiduciary responsibility to act in their clients' best interests. They also must make suitable recommendations and disclose conflicts of interest.

■ ENFORCEMENT

The SEC and the states can bring charges against firms or individuals they suspect of fraud, regardless of where they are registered. Sanctions include suspension of registration, fines, and expulsion from the securities industry. Both may make criminal referrals.



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by less-strict broker-dealer rules. Lawyers, accountants, and others whose investment advice is "solely incidental" to their practice are excluded from the act, too. "The problem," says Barbara Roper, director of investment protection at the Consumer Federation of America, "is that there are no uniform, comprehensive standards that apply to all financial advisers."

In any case, being a registered investment adviser is no guarantee of competence. The SEC imposes no testing requirement at all. Most states require advisers to pass a three-hour test, but it's not considered daunting.

ONE-STOP SHOPPING

Investment advisers aren't inspected with an equal level of care, either. Vetting has improved since the early 1990s, when only 1 in 27 registered advisers faced SEC inspection in a given year. The 1996 law that divided oversight between the agency and the states eased the SEC's load. Since then, the SEC says it has met its goal of auditing each of the

7,600 firms it oversees every five years.

State inspection regimes vary widely. Maryland audits advisers once every five years; Texas aims for every two years. Instead of routine inspections, many states are targeting advisers who pose special risks, such as those who have custody of client funds, says

closure Web site. There, you can up an adviser's Form ADV, check registration status, link to a state regulator's site, and jump to the Central Registration Depository Public Disclosure site for information on broker-dealer

To find a Form ADV, choose Investment Advisor Search, and type in

Be careful about lawyers, accountants, and others whose investment advice is incidental to their practice: They are not bound by adviser regulations

Kristina Kneip, a senior examiner in Washington state's securities division.

The good news is that the SEC and the states use a uniform registration form—called Form ADV—and it's accessible online. Part 1 gives the adviser's business and disciplinary history. Part 2 details services, fees, and strategies.

To look up an adviser's Form ADV, go to the SEC home page on the Web (www.sec.gov), click on Check Out Brokers and Advisers, and follow the links to the Investment Adviser Public Dis-

closure Web site. So far, only Part 1 is online, but you can request a copy of Part 2 from state securities regulators. SEC registered firms must make copies available to clients on request.

In a perfect world, financial advisers would all be subject to the same rules. That's not likely to happen soon, but at least investors now can do more than stop shopping to get information. Don't make the mistake Prappas and Wilbur did. Check out the adviser's bona fides. It takes just a few mouse clicks.



Checking Out Your Broker

Over the past two years, complaints against stockbrokers have surged to record highs. To find a broker you can trust, an important step in the vetting process is doing a background check. If a broker has had run-ins with investors or been convicted of a crime, you can find out in records securities regulators make available to the public. Even if you uncover no wrongdoing, simply inspecting a broker's employment history can be useful. How do you play detective? Follow one of two paths:

PATH 1

1 Go to nasdr.com, site of the National Association of Securities Dealers. Click on Broker/Advisor, then NASD Regulation Public Disclosure Program, then Perform an Online Search.

2 Type in a broker's name and firm. You should see a job history dating back 10 years and the states where the broker is licensed. If the broker has switched firms frequently, ask why.

3 To find out if a broker has been convicted of a felony or filed for bankruptcy, click on Disclosure Events. If "Maybe" appears, request e-mail copies of the records.

4 If the broker has been involved in securities arbitrations go to www.nasdr.com for further details.

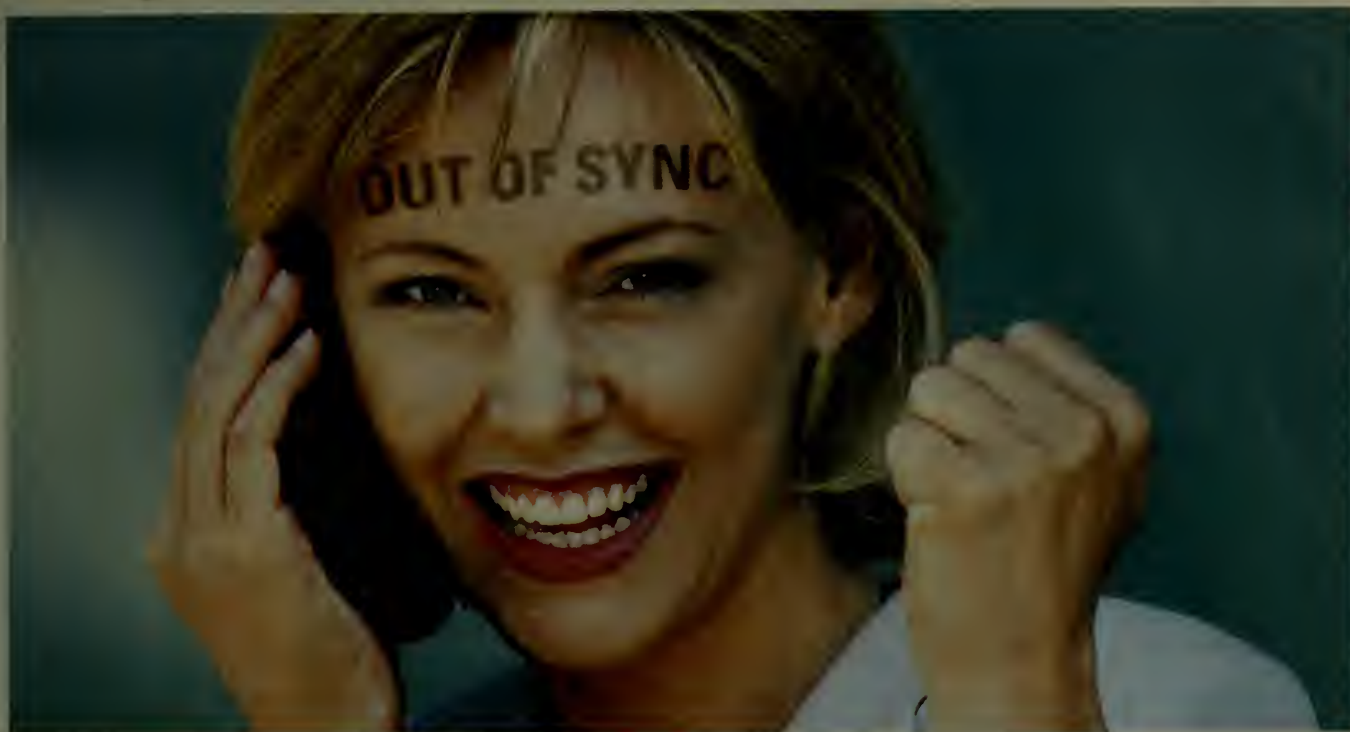
PATH 2

1 Find links to state securities regulators by visiting nasaa.org, the site of the North American Securities Administrators Assn. State regulators can

send you Central Registration Depository (CRD) reports, which offer more detailed disciplinary records than those NASD provides.

2 Call the phone number listed at your state regulator's Web site to request a broker's CRD report. (Unfortunately, states don't offer this

information online.) The report may take weeks to arrive, but it's usually worth waiting for. It often lists complaints that don't appear at NASD's site.



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Where They're Piling on the Perks

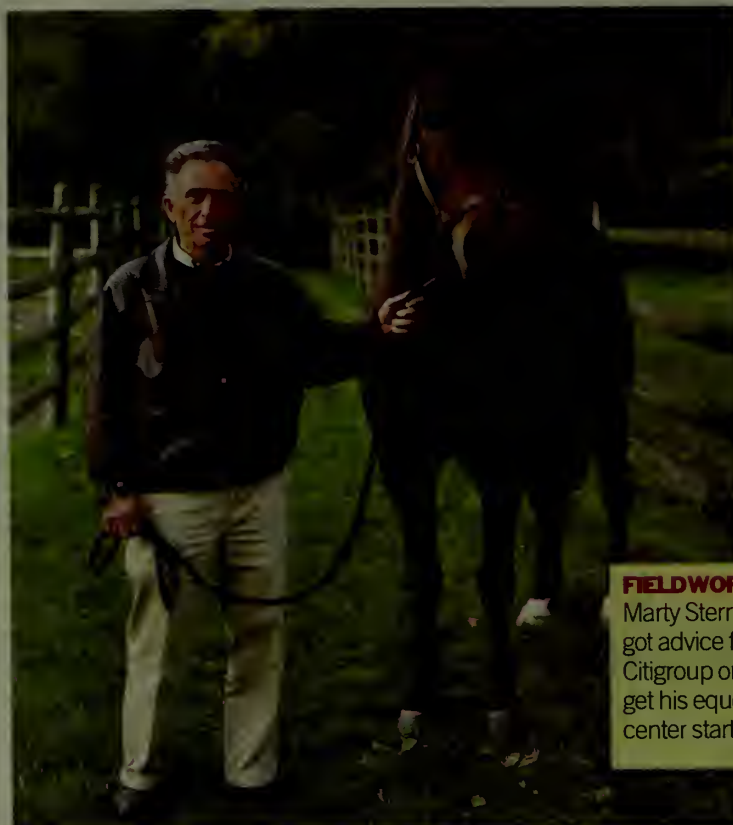
For the superrich, private bankers even help around the farm.

BY ANNE TERGESEN

SOON AFTER Marty Sternberg and four partners purchased a 28-acre riding stable in Old Westbury, N.Y., they turned to Citigroup for help in managing the staff and equipment. Turned to whom? While providing advice on running an equestrian facility may seem a world away from traditional banking services, it is one of several specialized products Citigroup offers clients of its private bank. "This will make the farm more efficient," Sternberg says of the daily, weekly, and monthly maintenance and staffing schedules Citigroup devised for him.

In recent years, the private banks that cater to the superrich—often defined as those with assets in excess of \$5 million—have piled on perks and expanded their expertise to include non-financial assets such as art, airplanes, and thoroughbreds. Merrill Lynch, for example, recently helped a client navigate the adoption process. Meanwhile, the private banks at both Citigroup and J.P. Morgan Chase have experts who scour the art world to locate treasures for clients.

Intense competition for customers is the driving force behind these extra services. Despite the stock market's slump, the ranks of those worth \$5 million or more rose from 578,000 in 2000 to 677,000 last year—the latest available figures, according to the Spectrem Group



FIELDWORK:

Marty Sternberg got advice from Citigroup on how to get his equestrian center started

consulting firm. Their accounts can generate fees of up to 1% a year, or \$50,000 on a \$5 million account, making this a lucrative business for the banks.

PAMPERED PEOPLE

Of course, private banks still cater mainly to clients' complex financial needs. Bankers spend most of their time shaping investment strategies and figuring out how to transfer money to the next generation while minimizing Uncle Sam's take. In the process, they offer access to hedge funds, derivatives, and other sophisticated investment products.

But private banking is all about pampering people, too. Bessemer Trust will take charge of your monthly bills. Merrill Lynch will score hard-to-get tickets to hit shows and sporting events.

Many now offer more than just golf services. Both J.P. Morgan and Citigroup have art experts who—for undisclosed fees—will educate neophytes or bid at auction for clients wishing to remain anonymous. The banks' advisers also

authenticate, insure, and value art pieces. If a client needs cash, they can arrange for a sale or a loan against the art.

Citigroup helps clients with everything for their farms—and their homes. Sandra Stern, head of Citigroup Private Bank's Multiple Residence and Farm Advisory Group, compiled a free inventory and maintenance schedule of the equipment, paddocks, fields, fences, and barns at Sternberg's riding center. She also created employee handbooks and performance appraisal forms to manage household staffs.

These days, private bankers are taking a more active role in educating clients about budgeting the nuts-and-bolts of money management and the special challenges that accompany wealth. J.P. M

organ sponsors conferences for the under-35 set featuring renowned finance professors. Its bankers also help families devise "mission statements," so they can agree on what they want to achieve with their wealth, says John Straus, who heads Morgan's U.S. private bank.

Meanwhile, Peter White, head of Citigroup Private Bank Family Advisory Practice, advises clients concerned about their kids becoming spoiled. He helps them address issues such as "whether to leave money to the kids, when, how much, and how to raise them." Try asking answers to those questions from your regular banker or broker.

Beyond Banking

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IS THIS A DREAM CRUISE FOR INVESTORS?

BY ROBERT BARKER rb@businessweek.com

THE PATH TO THE ALTAR is strewn with crushed hearts, some of them corporate. But no broken engagement between companies has proved quite so stunning as the one that befell Royal Caribbean International. It stood ready to seal a merger with P&O Princess Cruises before a congregation of investors. But then, rival suitor Carnival Cruise Lines swung in and grabbed enough shareholder votes at the meeting to halt what P&O Princess hailed as an investor "dream cruise." That was last Feb. 14, Valentine's Day.

Now, nine months, a few regulatory approvals, and much courting later, P&O Princess has kissed off Royal Caribbean and is betrothed to Carnival. If they tie the knot, Carnival will take P&O Princess in a stock deal valuing the combined company at \$23 billion. Despite the usual caveats attending any merger—not least those paid for in stock—the Carnival-P&O marriage looks sweet for investors. To see the deal this way, one must peer past some definite dangers on the horizon: war, higher oil prices, a second and deeper dip into recession. Yet when you look back at where the cruise industry has been and out toward where it's headed, it seems a safe bet that consolidation will shore up business at sea.

Not that the cruise biz is hurting for customers. Through its first three fiscal quarters, ended Aug. 31, industry leader Carnival boarded 2.6 million passengers on 44 ships, which sail under the banners of six different brands besides Carnival, including Holland America and Cunard Line. That was nearly as many passengers as sailed with Miami-based

Carnival in all of fiscal 2000. Unlike other travel businesses, Carnival actually saw its profit grow, by 2%, to \$825 million on \$3.3 billion in revenue through the nine months. Likewise, London-based P&O Princess' pretax profit climbed 9% through September this year, to \$310 million, on \$2 billion in revenue.

The shadow over all this nice growth is "net revenue yield." That's cruise lingo for the amount of revenue, after such costs of sales as travel agent commissions, per each available passenger berth. While industry



revenues have risen, yields keep slipping—by 4% in Carnival's first nine months of this fiscal year and by 6% in Princess' comparable period.

The culprit? Vast expansion of cruise fleets. On Nov. 1, for example, Carnival's biggest ship, the 2,974-passenger *quest*, is set for its maiden voyage from New Orleans to Cozumel, Mexico. All told, in five years Carnival has than doubled its berths and expects capacity to climb an 18% next year. Similarly, P&O Princess' capacity is up this year. This is why you can sail from, say, Port Canaveral, Fla., on a four-day Royal Caribbean cruise to the Bahamas for \$179. With so many new berths, the battle for market share is fought with discounts, sinking yields.

That won't change overnight. But Royal Caribbean already sees capacity growth slowing to 11% next year, twice that rate in 2001. If P&O Princess' 31,130 berths added to Carnival's 65,830 and brought under Carnival control, prices figure to firm, buoying profits. Carnival best set to exploit those berths: Measured by operating income per berth, its profitability tops P&O Princess' by a much higher than more leveraged Royal Caribbean's (see chart). Yet at \$29 a share, Carnival trades at less than 17 times Standard & Poor's estimate for profit this year, well below the average past multiple of 22. One risk: While P&O Princess recently paid \$63 million to get out of its deal with Royal Caribbean, Royal Caribbean could try to win back Princess with a higher bid. Time isn't short. With legal technicalities, P&O shareholders won't vote on the Carnival deal until next year. Tentative date? Feb. 14.

MONEY BOATS



*LATEST 12 MONTHS' DATA
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BY MARA DER HOVANESIAN

Sparkle at Tiffany's?

Wall Streeters and other big spenders may not be shopping much at Tiffany (TIF) on Fifth Avenue this Christmas. The company's flagship store turns in about a quarter of total U.S. sales, but its yearend revenues, like bankers' bonuses, could sag. Shares jumped on Nov. 13, to 26.6, however, when third-quarter operating earnings beat estimates by a penny. Still, the company has trimmed fourth-quarter profit and sales forecasts, and the stock is down 34% since May.

Next year, Tiffany could be a real gem, says Chris Wiles of Strong Capital Management, as the economy firms up and as the jeweler expands. Toronto's Aber Diamond, in which Tiffany holds a 14.7% stake, will start producing from its mine in early 2003. Tiffany will buy \$50 million worth of stones, one-third of its annual needs, from Aber and will also open its first diamond-cutting plant. In addition to all this, Tiffany is cash-rich with low debt. "This is an extremely high-quality company, with a near-pure balance sheet," says Wiles, who manages \$200 million in large-company stocks, including a small stake in Tiffany. He figures that, with a price-earnings ratio of 17.6 based on 2002 estimates, Tiffany sells at a 10% discount to the market. He says the stock could hit 40 next year.

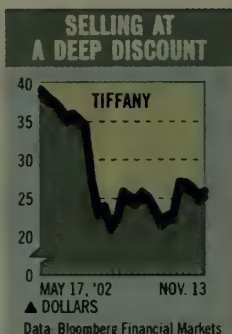
A newly acquired jewelry chain for the Caribbean cruise set, the November debut of a Paris store, and a fresh line of Tiffany watches are also pluses. Says Anne-Marie Peterson of Thomas Weisel Partners, who owns stock in her personal accounts: "There's a lot moving in the right direction."

Alaska Air Looks Like a Highflier

The old saw is: Never buy what Wall Street reveres. The flip side: Don't sell what others revile. And right now, everyone hates airlines—what with labor disputes, rising fuel costs, and travelers' terrorism jitters. But don't lump top-tier regionals like Alaska Air Group (ALK) in with the rest. The Seattle carrier has a stronghold in the Pacific Coast market, with a profitable commuter unit, Horizon Air. This year it beefed up, adding new planes and routes to Miami and

Newark, N.J. The stock's 23.8% loss this year looks bad. Bloomberg's U.S. Airlines Index is down 40%.

Most analysts downgraded future earnings after third-quarter profits slid nearly 60%. Ray Neidl of Blaylock & Partners has just upgraded Alaska from hold to buy. "I decided they were all wrong," says Neidl, who raised his 2003 earnings estimate from \$1.20 a share to \$1.79. His price target is 27, up from 22 now. Alaska is the one small-cap airline stock Gerard Heffernan of Lord Abbett owns. "Low debt and plenty of cash puts them in a secure position," he says. His firm, which manages \$1.6 billion in small-cap investments, has some 300,000 shares in the airline.



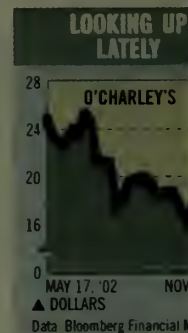
An Appetizing Aroma From O'Charley's

Nashville's O'Charley's (CHUX) is exporting Southern hospitality to Yankee territory. The casual-dining chain is heading for New England with a bid for Ninety Nine Restaurant & Bar. The deal, set to close early in 2003, will add 182 eateries to the existing 182. Small-restaurant stocks have just 10.8% on average this year, compared with a 23% gain for the S&P 500. O'Charley's stock has actually gained 8.1%.

The \$160 million price tag for privately held Ninety Nine was just 6.2 times trailing cash flow—"very attractive," says Robert Derrington of institutional broker Morgan Keegan. He upgraded O'Charley's to outperform after it hiked earnings targets to \$1.34 a share for 2002 and \$1.55 for 2003—not including what Ninety Nine kicks in. Derrington sees an easy 40% uptick in sales—"very fruitful to the bottom line."

Jeff Omohundro of Wachovia Securities reiterated his strong buy after the company beat third-quarter estimates. The stock trades at 11.8 times Omohundro's 2003 estimates, roughly half the peer-group's price. He sees a jump from \$20 to \$29 in a year.

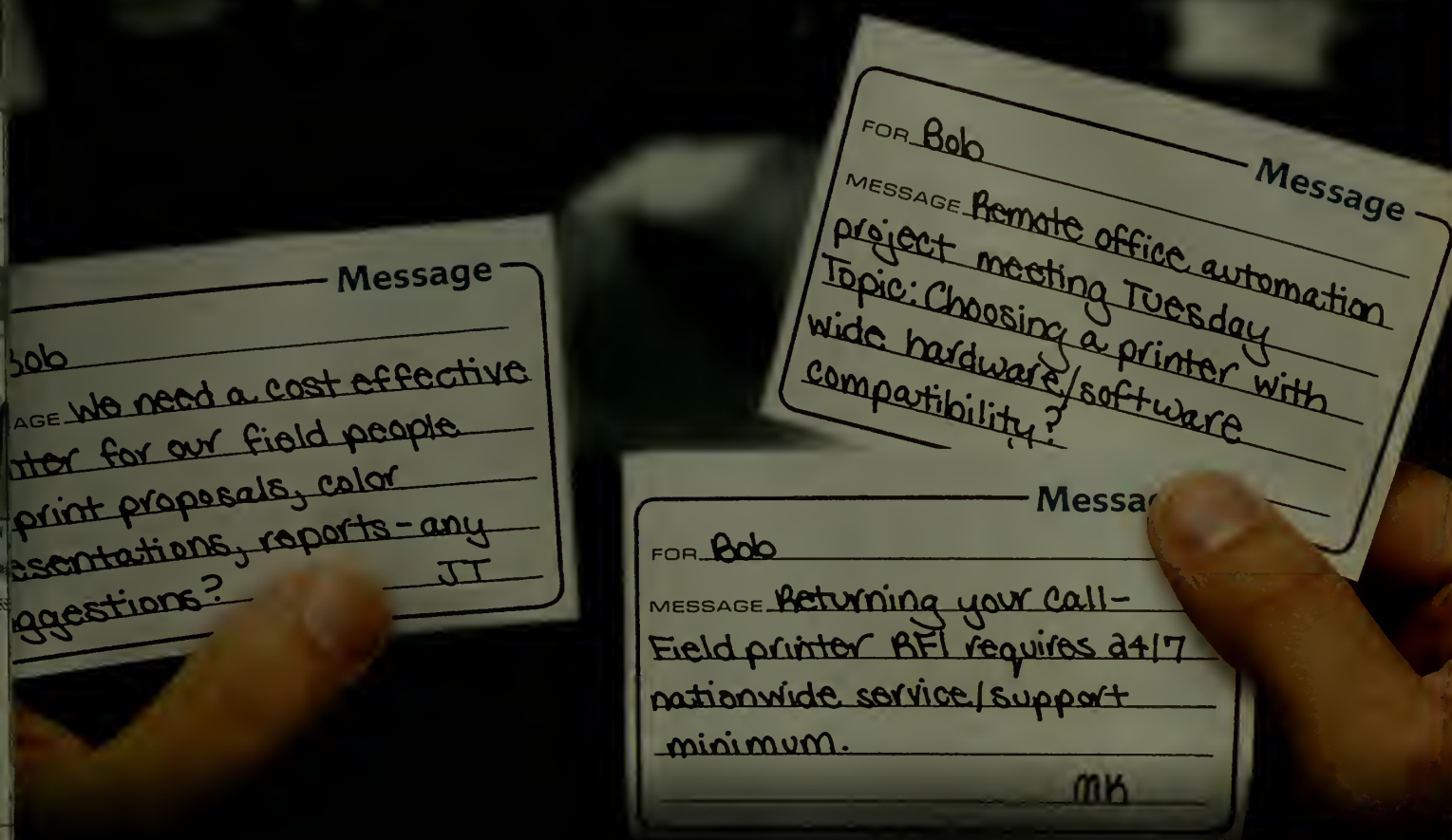
Gene Marcial is on vacation.



BusinessWeek online

Read Gene Marcial's Inside Wall Street Online column Tuesday afternoons at www.businessweek.com/today.htm. And see him Fridays at 1:40 p.m. EST on CNN's *The Money Gang*.

Unless otherwise noted, neither the sources cited in Inside Wall Street nor their firms hold positions in the stocks under discussion. Similarly, they have no investment banking or other financial relationships with the companies.



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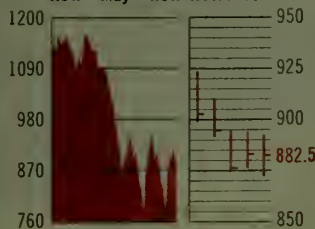


BusinessWeek Investor FIGURES OF THE WEEK

STOCKS

S&P 500

Nov. May Nov. Nov. 7-13



COMMENTARY

Federal Reserve Chairman Alan Greenspan's Nov. 13 testimony before Congress capped a concerted effort by Federal Reserve officials to talk up the U.S. economy in the face of dwindling monetary ammo. Trouble is, investors can't shake off the gloom. The S&P 500 fell four out of five days, with the worst drop coming on Nov. 11, Veterans' Day, on below-average volume.

Data: Bloomberg Financial Markets (Reuters)

U.S. MARKETS

	NOV. 13	WEEK	YEAR TO DATE	LAST 12 MONTHS
S&P 500	882.5	-4.5	-23.1	-22.5
Dow Jones Industrials	8398.5	-4.2	-16.2	-13.9
NASDAQ Composite	1361.3	-4.1	-30.2	-28.1
S&P MidCap 400	418.8	-4.6	-17.6	-12.7
S&P SmallCap 600	192.5	-4.1	-17.1	-9.4
Wilshire 5000	8330.8	-4.3	-22.2	-20.5

SECTORS

	NOV. 13	WEEK	YEAR TO DATE	LAST 12 MONTHS
BusinessWeek 50*	554.6	-4.5	-24	-26.3
BusinessWeek Info Tech 100**	291.0	-3.8	-30.6	-29.1
S&P/BARRA Growth	459.9	-3.6	-22.7	-22.0
S&P/BARRA Value	419.5	-5.4	-24.0	-23.6
S&P Energy	174.2	-5.6	-17.5	-19.0
S&P Financials	296.7	-4.6	-16.5	-15.6
S&P REIT	88.2	-2.2	-5.6	-2.4
S&P Transportation	169.6	-3.0	-13.9	-8.4
S&P Utilities	88.6	-9.2	-39.2	-43.6
GSTI Internet	78.0	-6.0	-25.7	-19.8
PSE Technology	458.9	-5.4	-33.3	-31.4

*Mar. 19, 1999 = 1000

**Feb. 7, 2000 = 1000

GLOBAL MARKETS

	NOV. 13	WEEK
S&P Euro Plus (U.S. Dollar)	827.7	-3.7
London (FT-SE 100)	4029.4	-1.8
Paris (CAC 40)	3034.8	-5.5
Frankfurt (DAX)	3066.4	-7.0
Tokyo (NIKKEI 225)	8438.5	-5.8
Hong Kong (Hang Seng)	9616.6	-1.6
Toronto (S&P/TSX Composite)	6301.8	-2.1
Mexico City (IPC)	5813.4	-4.1

FUNDAMENTALS

	NOV. 12	WK.
S&P 500 Dividend Yield	1.78%	1.1
S&P 500 P/E Ratio (Trailing 12 mos.)	28.8	29
S&P 500 P/E Ratio (Next 12 mos.)*	16.0	16
First Call Earnings Revision*	-2.43%	-2.8

TECHNICAL INDICATORS

	NOV. 12	WK. A
S&P 500 200-day average	994.5	1000
Stocks above 200-day average	21.0%	24
Options: Put/call ratio	0.79	0.7
Insiders: Vickers NYSE Sell/buy ratio	1.57	1.5

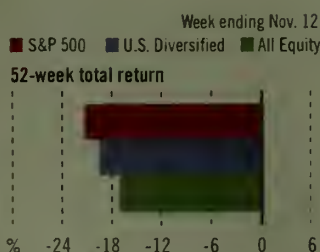
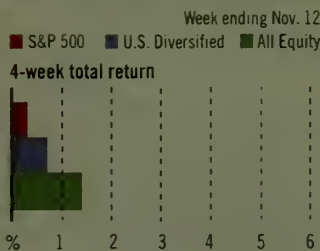
BEST-PERFORMING GROUPS

	LAST MONTH %	LAST 12 MONTHS %
Wireless Services	66.5	32.8
Office Electronics	47.4	27.6
Employment Services	30.6	22.6
Networking Equipment	30.2	19.8
Computer Stge. & Perphs.	27.9	16.3

WORST-PERFORMING GROUPS

	LAST MONTH %	LAST 12 MONTHS %
Health-Care Facilities	-37.3	Multi-Utilities
Tires & Rubber	-14.2	Telecomms. Equip.
Commercial Printing	-12.2	IT Consulting
Managed Health Care	-8.9	Wireless Services
Food Chains	-8.9	Instrumentation

MUTUAL FUNDS



Data: Standard & Poor's

EQUITY FUND CATEGORIES

4-WEEK TOTAL RETURN	%	52-WEEK TOTAL RETURN	%
LEADERS		LEADERS	
Precious Metals	9.0	Precious Metals	55.6
Technology	8.0	Real Estate	6.1
Communications	7.9	Pacific/Asia ex-Japan	2.5
Diversified Emerging Mkts.	6.1	Diversified Emerging Mkts.	1.7
LAGGARDS		LAGGARDS	
Natural Resources	-1.6	Technology	-40.0
Japan	-1.4	Communications	-39.2
Health	-0.8	Utilities	-29.4
Financial	-0.6	Health	-26.1

EQUITY FUNDS

4-WEEK TOTAL RETURN	%	52-WEEK TOTAL RETURN	%
LEADERS		LEADERS	
American Heritage	42.9	First Eagle SoGen Gold	86.2
Jacob Internet	32.1	Tocqueville Gold	72.7
Van Wagoner Emerging Gr.	21.4	Monterey OCM Gold	71.6
Frontier Equity	21.1	Gabelli Gold	71.6
LAGGARDS		LAGGARDS	
Fidelity Sel. Medical Del.	-25.4	ProFunds UltraOTC Inv.	-68.4
ProFunds UltraShort OTC	-13.7	Rydex Dynam. Velocity 100	-67.4
Rydex Dynam. Venture 100	-13.6	ProFunds UltraSemicondr.	-67.2
CGM Capital Development	-13.0	Black Oak Emerging Tech.	-64.7

INTEREST RATES

KEY RATES

	NOV. 13	WEEK AGO
MONEY MARKET FUNDS	1.28%	1.34%
90-DAY TREASURY BILLS	1.20	1.22
2-YEAR TREASURY NOTES	1.73	1.83
10-YEAR TREASURY NOTES	3.84	4.03
30-YEAR TREASURY BONDS	4.79	5.06
30-YEAR FIXED MORTGAGE†	5.93	6.14

BLOOMBERG MUNI YIELD EQUIVALENT

Taxable equivalent yields on AAA-rated, tax-exempt municipal bonds, assuming a 30% federal tax rate

	10-YR. BOND
GENERAL OBLIGATIONS	3.68%
TAXABLE EQUIVALENT	5.26
INSURED REVENUE BONDS	3.80
TAXABLE EQUIVALENT	5.43

THE WEEK AHEAD

CONSUMER PRICE INDEX Tuesday, Nov. 19, 8:30 a.m. EST ► Consumer prices for goods and services are forecast to have increased by 0.2% in October, following a 0.2% rise in September. That's according to the median forecast of economists surveyed by MMS International. Excluding the food and energy components, core inflation probably grew by a similar 0.2%, after a 0.1% gain in September.

INTERNATIONAL TRADE Tuesday, Nov. 19, 8:30 a.m. EST ► The foreign trade deficit

most likely narrowed to \$37.7 billion in September, after hitting a record level of \$38.5 billion during August.

NEW RESIDENTIAL CONSTRUCTION Wednesday, Nov. 20, 8:30 a.m. EST ► Housing starts during October probably slowed to an annual rate of 1.72 million, after climbing to 1.84 million in September.

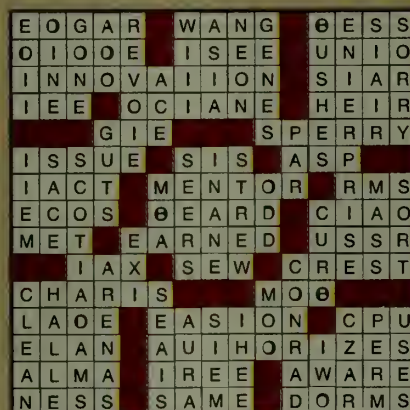
LEADING INDICATORS Thursday, Nov. 21, 10 a.m. EST ► The Conference Board's index of leading indicators is expected to

have slipped 0.1% in October. It has been gradually falling since

FEDERAL BUDGET Thursday, Nov. 21, 10 a.m. EST ► The federal government will report a deficit for October. The deficit for fiscal year 2002 ended on Sept. 30, totaled \$158.5 billion. With government spending set to rebound in tax revenues unlikely, the possibility of war with Iraq, the FY 2003 will most likely exceed year's total.

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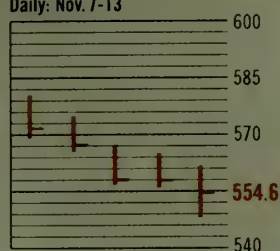
BUSINESSWEEK FIFTY

May

Nov.

Daily: Nov. 7-13

Weekly



50 fell 4.5% for the week as 45 out of the 50 stocks posted declines. Leading the losers was Tenet, sinking 43.7%, as its COO and CFO departed after a Medicare audit and a separate probe into doctors had performed unnecessary procedures. H&R Block fell 25.0% on questions concerning its mortu-
business. Investors flocked to Wal-Mart, up 1.2% for the week, on news that its net income rose 23%.

WEEKLY PERFORMANCE			% CHANGE			% CHANGE		
			SINCE			SINCE		
COMPANY	WEEK	3/1/02	RANK	COMPANY	WEEK	3/1/02		
Johnson & Johnson	-0.6	-1.6	26	Tenet Healthcare	-43.7	-61.6		
3M	-8.0	-9.1	27	Household International	-10.0	-56.4		
Amgen	-3.1	-20.4	28	WellPoint Health Networks	-3.2	24.0		
Boeing	-5.8	-12.0	29	Washington Mutual	-5.0	6.1		
Costco	-10.5	-27.4	30	Duke Energy	-15.0	-47.3		
Encor	-9.3	-38.8	31	Kohl's	1.6	-10.0		
Home Depot	-5.7	-17.8	32	Bed Bath & Beyond	-3.6	1.3		
Intel	-3.2	-10.9	33	Cardinal Health	-3.1	2.6		
Wal-Mart	-3.3	-57.6	34	Centex	-9.0	-25.3		
ResourceBerg	-6.9	-1.8	35	American Electric Power	-9.1	-40.7		
Health Group	-4.6	24.4	36	Golden West Financial	-3.2	5.6		
Johnson	-5.5	0.8	37	Stryker	-2.2	5.3		
Depot	-4.8	-46.1	38	Harley-Davidson	-8.3	-4.4		
Wal-Mart Stores	1.2	-11.3	39	PepsiCo	-0.3	-14.0		
Wal-Mart	7.9	-96.8	40	Merck	-5.7	-13.9		
3M	-3.7	-13.1	41	Apache	-8.2	-5.2		
Pharmacia	-4.9	-21.2	42	Amerada Hess	-1.0	-26.0		
Johnson & Johnson	0.1	27.3	43	KB Home	-9.4	-2.2		
Johnson & Johnson	-25.0	-39.1	44	First Data	-7.5	-15.8		
Johnson & Johnson	-11.4	-56.5	45	Tyco International	-5.6	-48.4		
Johnson & Johnson	-5.1	-0.3	46	International Game Technology	-0.3	11.3		
Johnson & Johnson	0.0	7.8	47	Capital One Financial	-14.8	-42.8		
Johnson & Johnson	-10.0	-17.4	48	Electronic Data Systems	-14.9	-75.8		
Johnson & Johnson	-2.7	-25.8	49	Nabors Industries	-11.5	-3.0		
Johnson & Johnson	-7.6	-17.5	50	Xcel Energy	-19.1	-61.6		

PRODUCTION INDEX

Change from last week: -0.2%
Change from last year: 2.0%

INDUSTRIAL OUTPUT NOV. 2=162.9 1992=100

The index is a 4-week moving average



Production index inched a little lower. Before calculating the moving average, however, the index rose to 162.8. After seasonal adjustments, steel output was the furthest. Still, tariffs and fewer domestic shipments are opening the way for price increases in long-haul industry supply contracts. Output of trucks, rail-freight traffic were also lower. Autos, however, production, and crude oil refining were unchanged.

Each of the index components is at www.businessweek.com
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For more investment data and the components of the production index, visit www.businessweek.com

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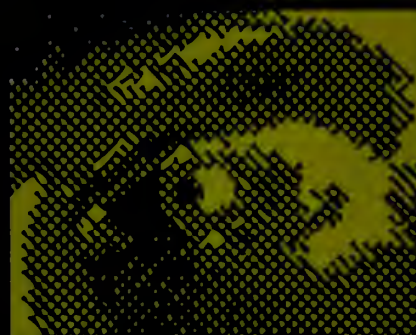
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health. IDEA is important in such challenging economic times when innovation
differentiates products in the market place."

— Bruce Nussbaum, H/IDSA, Design Editor at BusinessWeek

ELIOT SPITZER'S BAD IDEA

Pssst. Want a hot stock pick from the government? We didn't think so, which is why the proposal by New York Attorney General Eliot Spitzer to set up a government-appointed board that would buy independent stock market research for small investors fell flat on its face. The alternative idea being floated by Spitzer, that Wall Street firms directly buy independent analysis and distribute it alongside their own, isn't much better. It won't end the appearance, if not the reality, of conflict of interest. To his credit, Spitzer is the one regulator who has steadfastly championed the small investor over the past scandal-ridden year. His negotiations with Merrill Lynch & Co. and Credit Suisse First Boston have forced them to pay hefty fines that went to settle claims by investors. But Spitzer's two attempts to end the conflict of interest between investment banking and research are not workable. There is a better way.

Citigroup may have it. Citi is under investigation for possible conflicts of interest regarding telecom analyst Jack Grubman and its allocation of initial public offering shares to CEOs in exchange for corporate business. To clean up its act, Citi has decided to split off global research and retail brokerage operations into a new division. To run it, Citi has hired Sallie L. Krawcheck, the former chairman and chief executive of Sanford C. Bernstein & Co., a leading boutique stock research company on Wall Street. Citi's solution isn't perfect.

Krawcheck still reports directly to Citi CEO Sanford I. who admits he asked Grubman to review his rating of when he was on its board of directors. But Citi's solution is still cleaner than Spitzer's. It puts plenty of air between analysts and investment bankers while making its most valuable stock research available to all Citi clients, big and small—a better model for all of Wall Street.

Spitzer and the big Wall Street firms want a single "settlement" that allows them to keep their most valuable analysts tied to investment banking while putting the scandal behind them. But it might be better for Spitzer to correct his investigations into wrongdoing on Wall Street, punish those who have broken the law, and urge Wall Street to follow the Citigroup example of hiving off research—the brokerage paying for it—into an independent unit.

Spitzer should also go further and end the long-standing and corrupting Wall Street practice of secretly allocating stock to special friends, be they big investors or CEOs, in order to throw back corporate business in return. IPOs should be allocated through an open-auction system that gives all investors a chance to make money—or lose it.

It would be far better for the Securities & Exchange Commission to take charge of reforming Wall Street under ex-Chairman Harvey L. Pitt, it didn't step up. That's the job it to Spitzer, who should finish the job.

THE RIGHT ECONOMIC STIMULUS

As President Bush prepares an economic package for his January State of the Union message, we have this piece of advice: be pragmatic and be bold. Save talk of making the \$1.3 trillion tax cut permanent for the campaign in 2004—because, frankly, the proposal is all about politics anyway. It will have virtually no effect on spending next year. Besides, we all know that nothing is permanent in Washington, especially the tax code. Focus instead on the three realities that will shape economic growth in 2003: uncertainties about a war on Iraq, business' decision to continue cutting payrolls and curtail investment well into the year, and states' and cities' raising taxes sharply. These three factors threaten to push the economy down, perhaps into a double dip.

Mr. President, here's what you should do. Despite public antagonism toward Corporate America, its sins of the past should not stop you from trying to boost business investment. The boldest move would be to reduce double taxation on dividends and give the break to companies, not individual shareholders. While corporate corruption makes this politically difficult, it is the economically pragmatic course. A significant cut would lift the aftertax rate of return, boost price-earnings ratios, help the stock of dividend-paying companies, and seriously promote investment. Rising stocks should also re-

store wealth to the investor class and promote consumption.

Another bold move you should consider is cutting the payroll tax for the first half of next year. Since companies and individuals equally pay for Social Security, both would benefit. In one policy move, you promote consumption and investment. This is a controversial gambit, but these are unusual times.

If a payroll tax holiday is too hot to handle, then consider moving up the income tax cuts scheduled for 2004 and 2003. Mr. President, remember that state tax receipts fell 10.4% in the second quarter of this year. Real estate, and income taxes are rising all over the country. Just to set this fiscal drag, Washington has to cut taxes.

The American economy has rarely faced war, deflation, and a burst tech bubble at the same time. The worst mistake Mr. President, would be to act cautiously. To help pay for a strong stimulus package that has a broad impact, you should reconsider two very expensive plans that rain riches down on a very narrow part of society. Capping the inheritance tax exemption at \$5 million would cover 99% of all Americans and save billions. Cutting back on the monstrous subsidy would do the same. Mr. President, being economically bold requires you to be politically courageous. With a past election, you can afford to be.



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BusinessWeek

PER 2, 2002

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THE NEW FACE OF PHILANTHROPY

Donors are more ambitious, get more involved, and demand results. SPECIAL REPORT PAGE 82



LINDA AND BILL GATES
TOTAL GIVING: \$26 BILLION

ELI BROAD
TOTAL GIVING: \$1.1 BILLION

JAMES AND VIRGINIA STOWERS
TOTAL GIVING: \$1.5 BILLION

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PLUS: Our exclusive ranking of the most generous givers—and a look at a few cheapskates

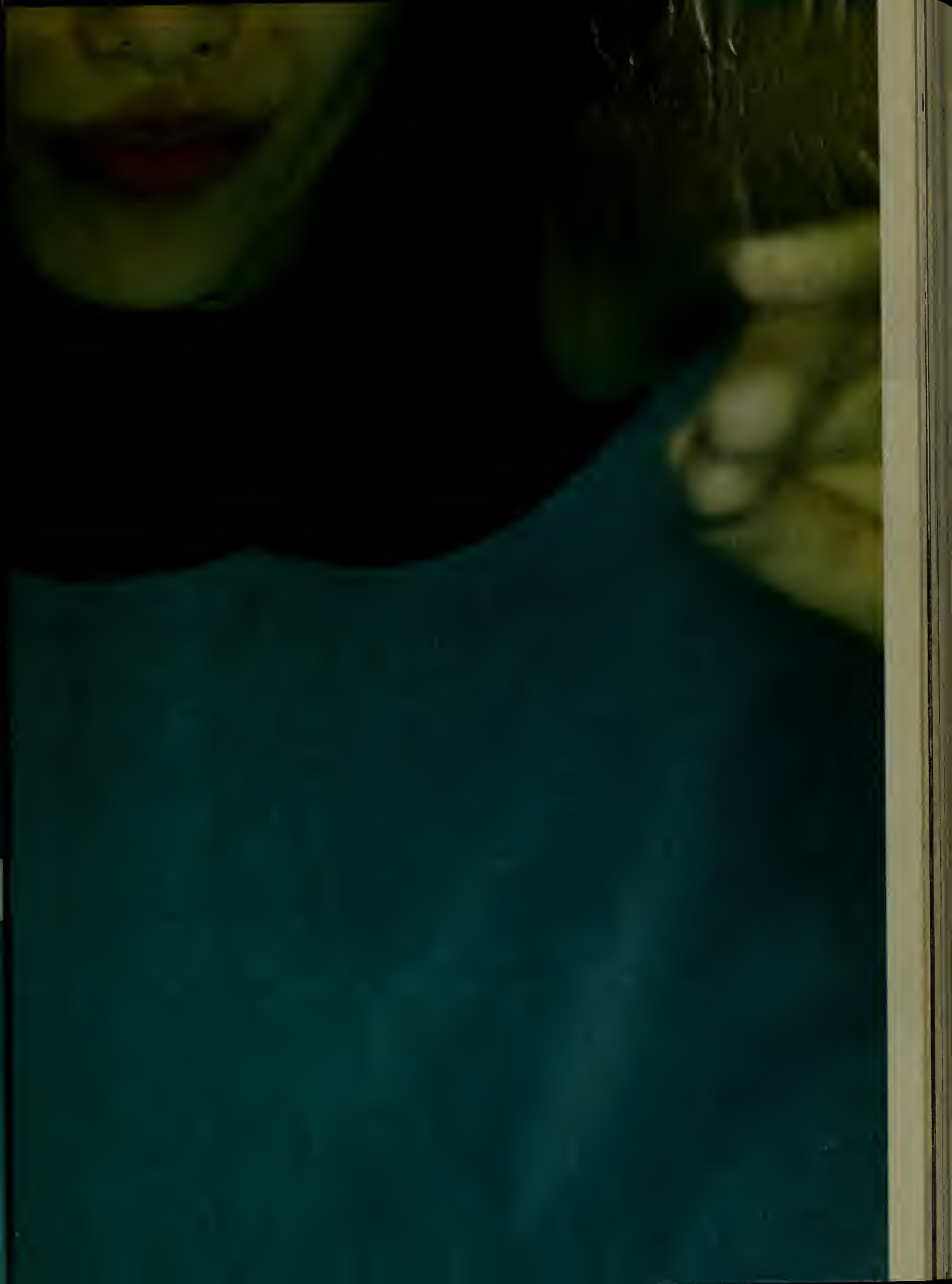


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Today's wealthy donors are actively engaged in projects that become passions. They're more ambitious in their goals—and demand results. *BusinessWeek's* 50 most generous givers are ranked by total contributions, and also by what the amount is as a percentage of their net worth. Plus, there's a tally of America's most innovative new philanthropists. And skinflints? We've got their numbers, too

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S&P's Jonathan Rudy likes video-game makers Activision and Electronic Arts



BEWARE:

Market strategist Bernie Schaeffer says investors should move cautiously because the bear is still about



TOOLS

YOUR PORTFOLIO:

Check on the health of your investments



STOCK SCREENER:

Use more than 70 criteria to pan for gold among the equities



MBA SEARCH: Which is the right business school for you and your needs?



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Land of Opportunity

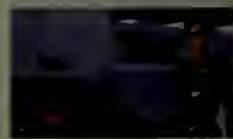
For Microsoft, that would be Asia, where it sees a hotbed of future growth. And as Bill Gates's recent visit to India showed, he's rushing to make sure that Windows, not Linux, is the OS of choice



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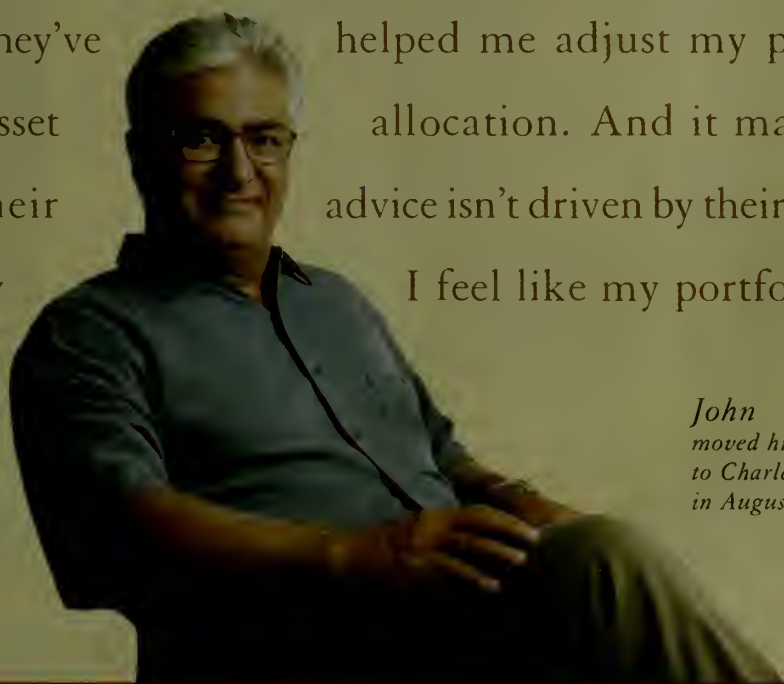
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Up Front

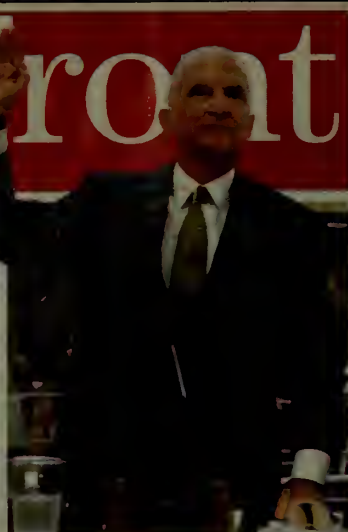
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ELECTRICAL STORM

ROSS ISN'T OFF THE HOOK YET

TO HEAR THE EXECS AT PEROT Systems tell it, an investigation into the company's role in California's energy crisis is winding down. In a recent conference call with analysts, general counsel Peter Altabef agreed with an analyst who said "the California cloud" was passing. Altabef also said the company would not incur any more big legal bills because of the inquiry.

Not so fast, says Joseph Dunn, a California state senator who opened the probe in June. "It's not a dead issue." Dunn wants to hold new hearings to find out why George Backus, a consultant who worked with Perot Systems, turned up in the address book of Timothy Belden, an Enron trader who pleaded guilty to conspiracy charges. Backus says he disclosed his only meeting with Enron traders and doesn't



PEROT: Ghosts from Enron

know why he was in Belden's book. Through his attorney, Belden had no comment.

Dunn will keep asking if Perot Systems, which helped build California's energy-trading systems, tried to sell inside info about the market's flaws to energy companies. The company denies doing so. It says the talks were based on common knowledge and did not lead to any new business.

Ross Perot may have a more immediate worry: His company's stock has plunged 40% since the mess began. The snafu, says Sanford C. Bernstein analyst Rod Bourgeois, "has created a drag on the stock." Talk about a giant sucking sound. *Andrew Park*

TRADE WINDS

AN END TO GUM CONTROL?

AFTER TWO YEARS OF NEGOTIATIONS, on Nov. 19 the Bush Administration signed a free trade agreement with Singapore. The agreement covers investment, telecommunications, and financial services.

It also tackles what seems to be a more controversial topic: chewing gum. Is it possible that Singapore, famous for banning the sale of gum, has actually agreed to import the stuff?

Well, sort of. At the press conference announcing the deal, U.S. Trade Representa-

tive Robert Zoellick spoke carefully while addressing this sensitive topic: "On chewing gum, we have a modest entry point that is controlled in a certain fashion. But as you'll see in the final text, there has been some additional opening on that issue."

Zoellick refused to explain further or to release the text, which is being translated into legalese by lawyers on both sides. In response to suggestions that the U.S. is trying to cut too many free trade deals at once, Zoellick insisted, "We—to use a turn of phrase here—we can walk and chew gum at the same time." *Paul Magnusson*



TALK SHOW

"With a battle plan like the Bush Administration is proposing, instead of crossing the Delaware...Washington would have stayed on his side of the river and built a bureaucracy."

—Senator Robert Byrd, on the Homeland Security Act

REGULATION NATION

TENET: IN THE SEC'S SPOTLIGHT

TENET HEALTHCARE COULD end up being the first test of the Securities & Exchange Commission's tough new rules about CEO responsibility.

Like other CEOs, Tenet's Jeffrey Barbakow signed a sworn statement in August

that the hospital chain's SEC filings were accurate, to the best of his knowledge. But Tenet's filings did not fully disclose that roughly 20% of last year's earnings came from aggressive Medicare billing. Barbakow says that when he signed the statement, he didn't know how much



BARBAKOW: Full disclosure?

the billing strategy was affecting earnings: Since the scandal broke, Tenet's stock is down 62%, to \$18.

Just how much grief could the SEC give Barbakow? The Sarbanes-Oxley Act lets the

SEC investigate any company it suspects to have willfully misstated its earnings, although the act doesn't specify a penalty.

Tenet says it had an "informal meeting" with the SEC but that no investigation was under way. Tenet spokesman Harry Anderson says Tenet won't restate earnings and that Barbakow believes his certification was "appropriate, correct, and complete" in light of the information he had at the time.

The SEC may not be so easily persuaded. "The key is for [Barbakow] to demonstrate that an effective review process was in place" to ensure full and complete disclosure, says Charles Elson, director of the University of Delaware's Center for Corporate Governance. Indeed, today's SEC is likely to at least raise an eyebrow at any CEO who claims he just didn't know. *Arlene Weintraub*

THE LIST BIG MONEY AT NONPROFITS

Base salaries for the highest-paid heads of nonprofit institutions are comparable to those of most CEOs, but usually without the options and bonuses that boost corporate CEO pay.

Lilly Endowment Indianapolis	Pay Period 2001
Pay to: THOMAS LOFTON Chairman	\$ 775,000
Metropolitan Opera Assn. New York	Pay Period 2001
Pay to: JOSEPH VOLPE General Manager	\$ 725,000
Baylor College of Medicine Houston	Pay Period 2001
Pay to: RALPH FEIGIN President	\$ 715,000
University of Pennsylvania Philadelphia	Pay Period 2001
Pay to: JUDITH RODIN President	\$ 690,400
Ford Foundation New York	Pay Period 2001
Pay to: SUSAN BERRESFORD President	\$ 616,000

2001 DATA FROM THE 282 LARGEST NONPROFITS, EXCLUDING HOSPITALS, RELEASED ON OCT. 3
Data: The Chronicle of Philanthropy



THE RESTYLED 2003 AVALON. With a car this luxurious, only one question remains—sparkling or still?

GET THE FEELING



 **TOYOTA**

Up Front

Q&A

WHAT JOHN CHAMBERS SEES COMING

John Chambers, CEO of Cisco Systems, spoke to Editor-in-Chief Stephen Shepard on Nov. 14 at BusinessWeek's ongoing "Captains of Industry" series at the 92nd Street Y in New York. Excerpts:



TECH TAKE: "Brutal consolidation"

You were dyslexic as a child. How did you overcome that?

I didn't do very well at first. I actually read backwards. About the third grade, I got into real trouble. The teachers very nicely said, "You're probably not going to graduate from high school."

A person by the name of Ms. Anderson, who my parents found before learning disabilities were understood, worked with me for almost two years to help me learn how to work around it. If it hadn't been for her, I would not have gone very far.

How is Cisco doing in this harsh economic environment?

Cisco is at the heights of the '90s in every financial measurement except revenue growth. So this last quarter was one of our best: \$1 billion in profits, a billion plus in

cash, gross margin 69%, after-tax net income 21%. So what people are waiting to see is: Can we grow, and can the industry grow?

What's the outlook for tech?

You'll see a brutal consolidation. Those areas of technology that are just neat for technology's sake will not only be put on the back burner, they'll be taken off the stove. But the productivity that has been achieved over the last seven years was half due, probably, to network-based technology. I believe that you can drive productivity growth 3% to 5% per year.... As businesses come out of this cycle, you'll see them invest when they see technology that truly gives them productivity.

Are you worried about Chinese competitors?

China is generating as many engineers as the U.S. They only do 2% of the business the U.S. does. Not only jobs but companies will go where the best-educated workforce is.... So the competition from Asia will be huge.

Are you less likely today to go on someone else's board?

It's unlikely that I'll go on another board. I'm on Wal-Mart's board. I'll stay because I believe in them tremendously. But the risk/reward is dramatically out of whack at this present time.

Is there life after Cisco for John Chambers?

Absolutely.... As my way of giving back, I'd like to teach once I retire from Cisco.

For the expanded Q&A, go to www.businessweek.com

DRAWN & QUARTERED

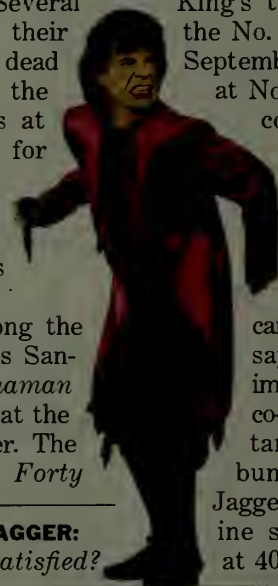


GOLDEN OLDIES

HERE'S HOW IT'S DONE, KIDS

FORGET GENERATION X AND Gen Y: It's a bunch of geezers propping up the ailing music industry. Several rockers well into their 50s, along with a dead guy, are topping the *Billboard* charts at once. So much for the conventional wisdom that pop music is only a young person's game.

Foremost among the oldsters is Carlos Santana, 55. His *Shaman* was ranked fifth at the end of November. The Rolling Stones' *Forty Licks* is at No. 20, with **JAGGER:** Mick Jagger *Satisfied?*



and Keith Richards both pushing 60. Rod Stewart, 59, is back on the charts with *Had To Be You*, a collection of standards at No. 14.

But the dead guy is outdoing them all. *Elvis: 30 # Hits*, a compilation of the King's top singles, claimed the No. 1 spot soon after its September release. It's now at No. 19, with 1.4 million copies sold so far.

"Both veteran artists and their albums are inspirations to all musicians, showing how a vital career can soar over decades," says 69-year-old music impresario Clive Davis, co-producer of the Santana and Stewart albums. And to think Jagger once couldn't imagine singing *Satisfaction* at 40. **Tom Lowry**

THE BIG PICTURE

HOW MANY SHOPPING DAYS LEFT?

Shoppers say they begin their holiday shopping:

IN OCTOBER OR EARLIER

41%

THE DAY AFTER THANKSGIVING

25%

SOMETIME IN DECEMBER

26%

ON CHRISTMAS EVE

7%

ONLINE POLL WITH 519 RESPONDENTS, OCTOBER 18-25

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HOW QUALIFIED ARE CEO COACHES—AND COACHED CEOs?

I'd like to add some information and perhaps clarify the statement in "CEO Coaches" (Management, Nov. 11) that "...there's no industry regulation: Hairdressers require more credentials." The International Coach Federation, an independent 6,000-member nonprofit professional association of personal, business, and executive coaches, seeks to preserve the integrity of coaching around the globe. The ICF has 179 chapters in 30 countries (www.coachfederation.org). ICF credentials are awarded to professional coaches and coach-training agencies that meet or exceed carefully crafted professional standards. This assures the public of the high standards of participating coaches and coach-training agencies and reinforces professional coaching as a distinct and self-regulating profession.

Judy Feld
 President-elect
 International Coach Federation
 Washington

First, many CEOs didn't know anything about accounting, and now, they need coaches to get a grip on interpersonal skills. Shouldn't they learn these things before they become CEOs?

Jitka Grubner
 Burlington, Vt.

AT LEAST FAT PEOPLE DON'T MAKE OTHERS PUT ON POUNDS

In pointing out a correlation in the recent rise in tobacco prices and an increase in the number of obese Americans, "Fewer puffers, more puffies" (Up Front, Nov. 11) stated that this is especially bad since "obesity causes even more chronic health problems than

smoking." However, let's not ignore the fact that one person's obesity does not directly affect the health of those around him, as second-hand smoke has been proven to do. While both smoking and obesity are huge health issues facing the U.S., smoking is a much more insidious health problem because of its untold effect on nonsmokers.

Susan Vaccaro
 Atlanta

HONG KONG'S INDEPENDENCE ISN'T IN DANGER

My answer to "Is the sun setting on Hong Kong's freedom?" (International Business, Nov. 18) is a categorical no. Our proposals to implement Article 2 of the Basic Law to protect national security are largely drawn from existing laws and fully comply with Hong Kong's well-established common-law traditions and international human-rights principles. With regard to the theft of "state secrets," the existing and proposed offenses are extremely narrowly drawn and based on Britain's Official Secrets Act (1989). The claim that journalists could be prosecuted merely for "unauthorized possession" of information is simply not true.

Nor is it true to say that our proposals would let authorities ban activities whenever they believe that doing so is "in the interests of national security or public safety or public order." All of our proposed measures are subject to the guarantees of the International Covenant on Civil & Political Rights, constitutionally entrenched and promulgated in Hong Kong through the Basic Law. Our proposals would apply only in the most severe of circumstances [such as] an act of violence, a threat of violence, or grave criminal conduct.

In the unfortunate and highly unlikely

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Readers Report

CORRECTIONS & CLARIFICATIONS

"Revenge of the retirees" (Working Life, Nov. 18), should have said that Nynex retirees haven't gotten a pension "cost-of-living increase" from the new parent company, Verizon Communications, since 1991.

In "The Stat" (BusinessWeek Investor, Nov. 18), the September outflow from equity mutual funds was the third worst, not the second-largest ever. The worst monthly cashout was July, 2002, not September, 2001, as originally reported.

Because of a production glitch, the map "The new shape of Europe" in "Mega Europe" (Special Report, Nov. 25) is misaligned and mislabeled. A correct version of the map can be viewed on BusinessWeek Online at businessweek.com/magazine/content/02_46/b3808711.htm

ly event that any of these offenses were committed, the cases will be heard in our own courts, which draw on a long common-law tradition and are fully cognizant of the international human-rights laws and standards that apply in Hong Kong. There is no question of extending mainland laws or concepts on national security to Hong Kong.

Regina Ip
Secretary for Security
Hong Kong
Special Administrative Region

THAT BUD WASN'T FOR HIM

In "Is this bud for you, August IV?" (People, Nov. 11), the writers resort to gossip, innuendo, and tabloid-type reporting. By any measure—sales, profitability, corporate growth, stock-price valuation—Anheuser-Busch Cos. is a gilt-edged corporation in the U.S., selling the highest-quality products. That was never mentioned or was glossed over. With your resources, you should be able to do better—though perhaps not as well as Anheuser-Busch does.

John C. Matesich III
Newark, Ohio

Editor's note: The writer is a wholesaler of Anheuser-Busch products.

THE PERILS OF PEN-BASED COMPUTING

Re "Is the pen finally mightier than the keyboard?" (Information Technology, Nov. 11): Yes, images of handwriting can be stored and transmitted fax-style,

but a well-designed tablet computer must have the ability to decipher handwriting in memos, forms, and spreadsheets and convert it to typewritten text. [Otherwise,] the powerful text and numerical processing power of the PC cannot be used.

For a truly functional machine, character recognition that is 99.9999% error-free (six nines) is the goal. Microsoft Corp. seems to be struggling to achieve a 90% rate. With 1 character in 10 in error, typists will find it faster to type in data than correct machine errors. The machine becomes marginally useful only at 99.9%. Microsoft's reputation for shipping software with loads of bugs means the first of these new machines will almost certainly be stinkers. Wake me in five years when they actually have a product.

Paul E. Eckler
Princeton Junction, N.J.

For many years, I have been using the Cross Pad digital notepad that is powered by IBM software. Perhaps this is a case where A.T. Cross and IBM dipped a toe in the water and, finding it too cold, abandoned the concept. Has Bill Gates once again recognized the next paradigm shift? Or is the Establishment correct after all? Who, apart from me, wants a PC that has the functionality of a piece of paper?

Gerald Michaluk
Glasgow

MAKING A BIG DIFFERENCE WITH THE SMALLEST OF LOANS

Re "Global poverty" (Special Report, Oct. 14): The soul of capitalism is alive and well in microcredit—tiny loans made to the very poorest people in the developing world so they can work themselves out of poverty.

It's hard to imagine the impact of a loan as small as \$15 to a very poor family—a loan to buy a loom or a cow to sell milk or a few vegetables to sell in the market. The first profits provide health care and a chance to go to primary school. Better sanitation and clean water are next on the list. Microcredit programs, directed to the poorest, are worthy of our increased support.

Randy Rudolph
Calgary

SUPERCHIPS MEAN LESS CHOICE FOR CONSUMERS

After more than 20 years in the semiconductor industry, I am a firm believer in the system-on-a-chip concept ("Dawn

of the superchip," Science & Technology, Industrial Management Edition, Nov. 4). However, I disagree with the statement: "For consumers, there is no downside." As entire systems are manufactured on a single integrated circuit, equipment manufacturers—and therefore consumers—are forced to purchase the "complete" system functionality from one company.

This restricts consumers' ability to economically configure best-of-breed (at least by their definition) systems. For example, there are excellent market reasons, in performance and cost, supporting Intel Corp.'s lead in memory chips and Texas Instruments Inc.'s lead in processors. Is the consumer better served by being forced to purchase telephone handsets built with systems-on-a-chip that include Intel's processors or TI's memory?

Agler Torn
Cypress, Calif.

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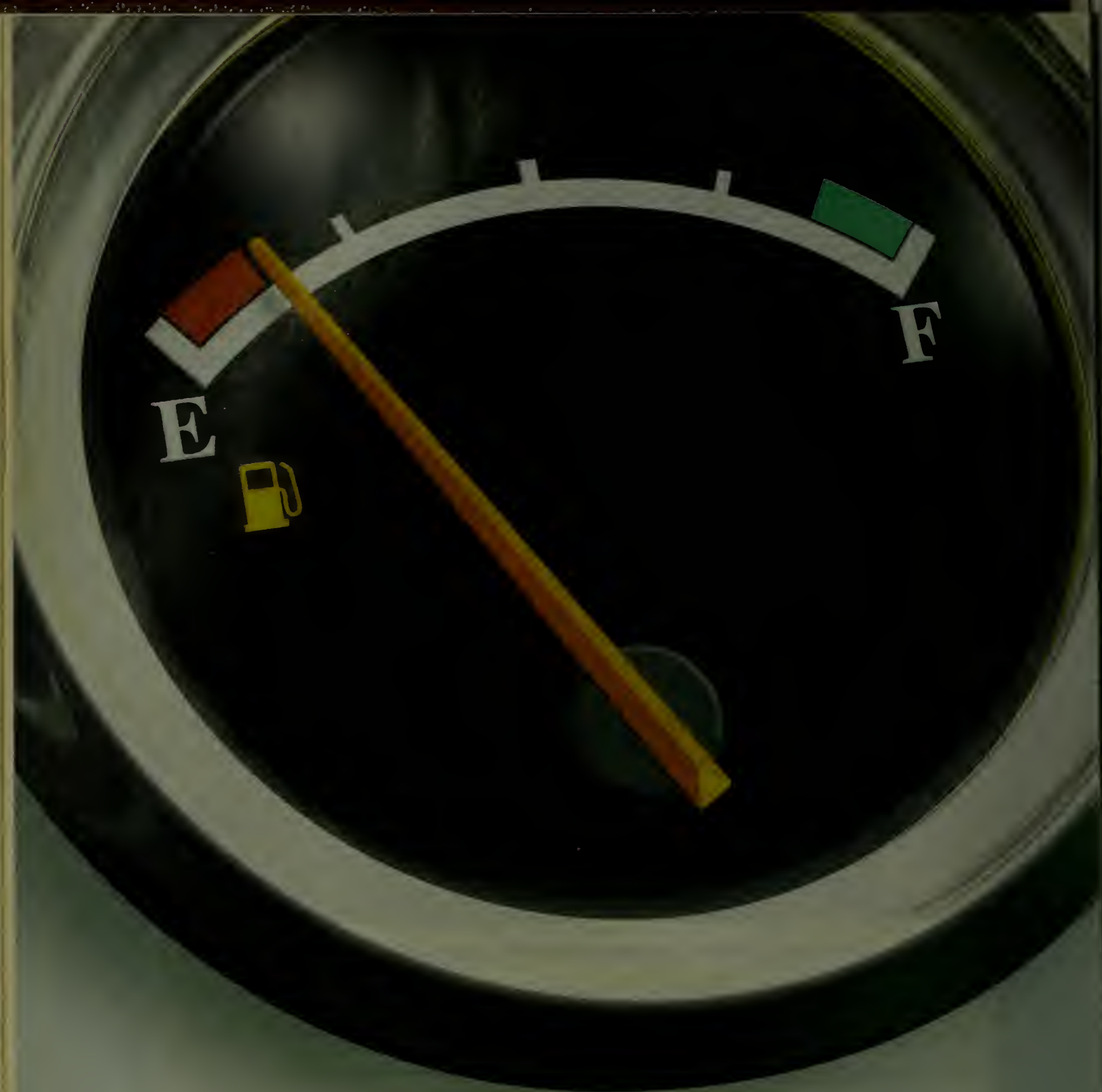
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• Adverse events possibly, probably or definitely related to use of AndroGel in a 1-year follow up (n=106) across all dose levels reported in at least 2% of patients included application site reaction 9.4%, prostate disorder 8.5%, acne 5.7%, and lab test abnormal 4.7%.

• Androgens are contraindicated in men with carcinoma of the breast, or known or suspected carcinoma of the prostate. Geriatric patients treated with androgens may be at an increased risk for the development of prostatic hyperplasia and prostatic carcinoma.

• To minimize the potential transfer of testosterone to another person, patients should wash their hands immediately with soap and water after application of AndroGel. They should cover the application site(s) with clothing after the gel has dried.



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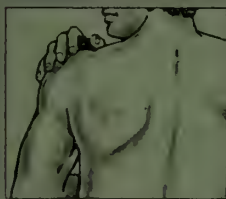
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1. www.fda.gov/fdac/departs/196_upd.html, accessed May 17, 2002

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INDICATIONS AND USAGE

AndroGel® is indicated for replacement therapy in males for conditions associated with a deficiency or absence of endogenous testosterone:

1. Primary hypogonadism (congenital or acquired)—testicular failure due to cryptorchidism, bilateral torsion, orchitis, vanishing testis syndrome, orchiectomy, Klinefelter's syndrome, chemotherapy, or toxic damage from alcohol or heavy metals. These men usually have low serum testosterone levels and gonadotropins (FSH, LH) above the normal range.
2. Hypogonadotropic hypogonadism (congenital or acquired)—idiopathic gonadotropin or luteinizing hormone-releasing hormone (LHRH) deficiency or pituitary-hypothalamic injury from tumors, trauma, or radiation. These men have low testosterone serum levels but have gonadotropins in the normal or low range.

AndroGel® has not been clinically evaluated in males under 18 years of age.

CONTRAINDICATIONS

Androgens are contraindicated in men with carcinoma of the breast or known or suspected carcinoma of the prostate.

AndroGel® is not indicated for use in women, has not been evaluated in women, and must not be used in women.

Pregnant women should avoid skin contact with AndroGel® application sites in men. Testosterone may cause fetal harm. In the event that unwashed or undressed skin to which AndroGel® has been applied does come in direct contact with the skin of a pregnant woman, the general area of contact on the woman should be washed with soap and water as soon as possible. *In vitro* studies show that residual testosterone is removed from the skin surface by washing with soap and water.

AndroGel® should not be used in patients with known hypersensitivity to any of its ingredients, including testosterone USP that is chemically synthesized from soy.

WARNINGS

1. Prolonged use of high doses of orally active 17-alpha-alkyl androgens (e.g., methyltestosterone) has been associated with serious hepatic adverse effects (peliosis hepatis, hepatic neoplasms, cholestatic hepatitis, and jaundice). Peliosis hepatis can be a life-threatening or fatal complication. Long-term therapy with testosterone enanthate, which elevates blood levels for prolonged periods, has produced multiple hepatic adenomas. Testosterone is not known to produce these adverse effects.
2. Geriatric patients treated with androgens may be at an increased risk for the development of prostatic hyperplasia and prostatic carcinoma.
3. Geriatric patients and other patients with clinical or demographic characteristics that are recognized to be associated with an increased risk of prostate cancer should be evaluated for the presence of prostate cancer prior to initiation of testosterone replacement therapy. In men receiving testosterone replacement therapy, surveillance for prostate cancer should be consistent with current practices for eugonadal men (see PRECAUTIONS: Carcinogenesis, Mutagenesis, Impairment of Fertility and Laboratory Tests).
4. Edema with or without congestive heart failure may be a serious complication in patients with preexisting cardiac, renal, or hepatic disease. In addition to discontinuation of the drug, diuretic therapy may be required.
5. Gynecomastia frequently develops and occasionally persists in patients being treated for hypogonadism.
6. The treatment of hypogonadal men with testosterone esters may potentiate sleep apnea in some patients, especially those with risk factors such as obesity or chronic lung diseases.

PRECAUTIONS

Transfer of testosterone to another person can occur when vigorous skin-to-skin contact is made with the application site (see Clinical Studies). The following precautions are recommended to minimize potential transfer of testosterone from AndroGel®-treated skin to another person:

- Patients should wash their hands immediately with soap and water after application of AndroGel®.
- Patients should cover the application site(s) with clothing after the gel has dried (e.g., a shirt).
- In the event that unwashed or undressed skin to which AndroGel® has been applied does come in direct contact with the skin of another person, the general area of contact on the other person should be washed with soap and water as soon as possible. *In vitro* studies show that residual testosterone is removed from the skin surface by washing with soap and water.

Changes in body hair distribution, significant increase in acne, or other signs of virilization of the female partner should be brought to the attention of a physician.

General

The physician should instruct patients to report any of the following:

- Too frequent or persistent erections of the penis.
- Any nausea, vomiting, changes in skin color, or ankle swelling.
- Breathing disturbances, including those associated with sleep.

Information for Patients

Advise patients to carefully read the information brochure that accompanies each carton of 30 AndroGel® single-use packets.

Advise patients of the following:

- AndroGel® should not be applied to the scrotum.
- AndroGel® should be applied once daily to clean, dry skin.
- After application of AndroGel®, it is currently unknown for how long showering or swimming should be delayed. For optimal absorption of testosterone, it appears reasonable to wait at least 5-6 hours after application prior to showering or swimming. Nevertheless, showering or swimming after just 1 hour should have a minimal effect on the amount of AndroGel® absorbed if done very infrequently.

Laboratory Tests

1. Hemoglobin and hematocrit levels should be checked periodically (to detect polycythemia) in patients on long-term androgen therapy.
2. Liver function, prostatic specific antigen, cholesterol, and high-density lipoprotein should be checked periodically.
3. To ensure proper dosing, serum testosterone concentrations should be measured (see DOSAGE AND ADMINISTRATION).

Drug Interactions

Oxyphenbutazone: Concurrent administration of oxyphenbutazone and androgens may result in elevated serum levels of oxyphenbutazone.

Insulin: In diabetic patients, the metabolic effects of androgens may decrease blood glucose and, therefore, insulin requirements.

Propranolol: In a published pharmacokinetic study of an injectable testosterone product, administration of testosterone cypionate led to an increased clearance of propranolol in the majority of men tested.

Corticosteroids: The concurrent administration of testosterone with ACTH or corticosteroids may enhance edema formation; thus, these drugs should be administered cautiously, particularly in patients with cardiac or hepatic disease.

Drug/Laboratory Test Interactions

Androgens may decrease levels of thyroxine-binding globulin, resulting in decreased total T4 serum levels and increased resin uptake of T3 and T4. Free thyroid hormone levels remain unchanged, however, and there is no clinical evidence of thyroid dysfunction.

Carcinogenesis, Mutagenesis, Impairment of Fertility

Animal Data: Testosterone has been tested by subcutaneous injection and implantation in mice and rats. In mice, the implant induced cervical-uterine tumors, which metastasized in some cases. There is suggestive evidence that injection of testosterone into some strains of female mice increases their susceptibility to hepatoma. Testosterone is also known to increase the number of tumors and decrease the degree of differentiation of chemically induced carcinomas of the liver in rats.

Human Data: There are rare reports of hepatocellular carcinoma in patients receiving long-term oral therapy with androgens in high doses. Withdrawal of the drugs did not lead to regression of the tumors in all cases.

Geriatric patients treated with androgens may be at an increased risk for the development of prostatic hyperplasia and prostatic carcinoma.

Geriatric patients and other patients with clinical or demographic characteristics that are recognized to be associated with an increased risk of prostate cancer should be evaluated for the presence of prostate cancer prior to initiation of testosterone replacement therapy.

In men receiving testosterone replacement therapy, surveillance for prostate cancer should be consistent with current practices for eugonadal men.

Pregnancy Category X (see Contraindications)—Teratogenic Effects: AndroGel® is not indicated for women and must not be used in women.

Nursing Mothers: AndroGel® is not indicated for women and must not be used in women.

Pediatric Use: Safety and efficacy of AndroGel® in pediatric patients have not been established.

ADVERSE REACTIONS

In a controlled clinical study, 154 patients were treated with AndroGel® for up to 6 months. Adverse events possibly, probably or definitely related to the use of AndroGel® and reported by ≥1% of the patients are listed in Table 1.

Table 1. Adverse Events Possibly, Probably or Definitely Related to Use of AndroGel® in the Controlled Clinical Trial

Adverse Event	5 g	7.5 g	10 g
Acne	1%	3%	8%
Alopecia	1%	0%	1%
Application Site Reaction	5%	3%	4%
Asthenia	0%	3%	1%
Depression	1%	0%	1%
Emotional Lability	0%	3%	3%
Gynecomastia	1%	0%	3%
Headache	4%	3%	0%
Hypertension	3%	0%	3%
Lab Test Abnormal*	6%	5%	3%
Libido Decreased	0%	3%	1%
Nervousness	0%	3%	1%
Pain Breast	1%	3%	1%
Prostate Disorder**	3%	3%	5%
Testis Disorder	3%	0%	0%

*Lab test abnormal occurred in nine patients with one or more of the following events: elevated hemoglobin or hematocrit, hyperlipidemia, elevated triglycerides, hypokalemia, decreased HDL, elevated glucose, elevated creatinine, or elevated total bilirubin.

**Prostate disorders included five patients with enlarged prostate, one patient with BPH, and one patient with elevated PSA results.

The following adverse events possibly related to the use of AndroGel® occurred in fewer than 1% of patients: amnesia, anxiety, discolored hair, dizziness, dry skin, hirsutism, hostil impaired urination, paresthesia, penis disorder, peripheral edema, sweating, and vasodilation.

In this clinical trial of AndroGel®, skin reactions at the site of application were occasionally reported with AndroGel®, but none was severe enough to require treatment or discontinuation of drug.

Six (4%) patients in this trial had adverse events that led to discontinuation of AndroGel®. These events included the following: cerebral hemorrhage, convulsion (neither of which were considered related to AndroGel® administration), depression, sadness, memory loss, elevated prostate specific antigen and hypertension. No AndroGel® patients discontinued due to skin reactions.

In an uncontrolled pharmacokinetic study of 10 patients, 10 had adverse events associated with AndroGel®; these were asthenia and depression in one patient and increased libido and hyperkinesia in the other. Among 17 patients in foreign clinical studies there was one instance each of acne, erythema and benign prostate adenoma associated with a 2.5% testosterone gel formulation applied dermally.

One hundred six (106) patients have received AndroGel® for up to 12 months in a long-term follow-up study for patient who completed the controlled clinical trial. The preliminary safety results from this study are consistent with those reported for the controlled clinical trial. Table 2 summarizes those adverse events possibly, probably or definitely related to the use of AndroGel® and reported by at least 1% of the total number of patients during long-term exposure to AndroGel®.

Table 2. Incidence of Adverse Events Possibly, Probably or Definitely Related to the Use of AndroGel® in the Long-Term, Follow-up Study

Adverse Event	Dose of AndroGel®		
	5 g	7.5 g	10 g
Lab Test Abnormal*	4.2%	0.0%	6.3%
Peripheral Edema	1.4%	0.0%	3.1%
Acne	2.8%	0.0%	12.5%
Application Site Reaction	9.7%	10.0%	3.1%
Prostate Disorder**	2.8%	5.0%	18.8%
Urination Impaired	2.8%	0.0%	0.0%

*Lab test abnormal included one patient each with elevated GGT, elevated hematocrit and hemoglobin, increased total bilirubin, worsened hyperlipidemia, decreased HDL, and hypokalemia.

**Prostate disorders included enlarged prostate, elevated PSA results, and in one patient, a new diagnosis of prostate cancer; three patients (one taking 7.5 g daily and two taking 10 g daily) discontinued AndroGel® treatment during the long-term study because of such disorders.

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Oral ingestion of AndroGel® will not result in clinically significant serum testosterone concentrations due to extensive first-pass metabolism.

OVERDOSAGE

There is one report of acute overdose by injection of testosterone enanthate: testosterone levels of up to 11,400 ng/dL were implicated in a cerebrovascular accident.

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The recommended starting dose of AndroGel® 1% is 5 g delivering 5 mg of testosterone systemically, applied once daily (preferably in the morning) to clean, dry, intact skin of the shoulders and upper arms and/or abdomen. Upon opening the packet(s), the entire contents should be squeezed into the palm of the hand and immediately applied to the application sites. Application sites should be allowed to dry for a few minutes prior to dressing. Hands should be washed with soap and water after AndroGel® has been applied.

Do not apply AndroGel® to the genitals.

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RUPERT MURDOCH

The Untold Story of the World's Greatest Media Wizard

Neil Chenoweth

Doubtful Business • 398pp • \$27.50

THROWING KNIVES AT RUPERT MURDOCH

The summer of 1996 was a busy time for Rupert Murdoch. In New York, the transplanted Australian was calling in political favors to get News Corp.'s Fox News channel on the Warner Inc.'s cable-TV system, plotting to grab a string of TV stations controlled by financier Ron Perelman, and suing the former head of a News Corp.-owned company for fraud. That case also featured a raid of the unit's Jerusalem offices by Israeli tax collectors.

It is enough to make your head swim—but such moments are not unusual in the life of the media magnate. In the past 49 years, since taking over his late father's debt-ridden newspaper in Australia, Rupert Murdoch has built one of the world's most complex, far-reaching empires—a globe-girdling collection of satellites, newspapers, TV stations, and film studios. It hasn't always been easy. The 71-year-old Murdoch struggled with junk-bond debt in the mid-1980s and nearly lost his company to a banking consortium in 1991. His operations have at various times been outlawed in China and India, and he was investigated by the Federal Communications Commission for providing misleading documents about the ownership of his U.S. TV stations.

In short, Murdoch is no stranger to controversy. And in *Rupert Murdoch: The Untold Story of the World's Greatest Media Wizard*, Australian journalist Neil Chenoweth amasses what seems like every detail of Murdoch's life, encompassing his early Leninist leanings, his three marriages, and his numerous convoluted business transactions. "He is probably the most influential and powerful media figure in the world," Chenoweth writes in his introduction.

Chenoweth is an able wordsmith, but this is not an easy book to negotiate. It is larded with minutiae that often lack an organizing principle, and the author

has a tendency to skip back and forth in the narrative like a VCR switched between fast-forward and rewind. There is a stupefyingly large jumble of characters. Moreover, for those who know Murdoch, this book is hardly the "untold story" promised by the subtitle. Chenoweth's book is an amalgamation of everything that has ever been written about the man, from William Shawcross' *Murdoch: The Making of a Media Empire* to Ken Auletta's *The Highwaymen: Warriors of the Information Highway*.

Of greater concern is that Chenoweth spies a Murdoch-led conspiracy at every turn, despite evidence to the contrary. Did Murdoch really hoodwink a sophisticated investor like Ron Perelman in the aftermath of News Corp.'s \$2.48 billion purchase of Perelman's TV stations? Perelman was hardly "in the dark" that the newly diluted stock would drop following the deal. Certainly, Murdoch sometimes plays fast and loose with the rules: He used his *New York Post* to pressure Time Warner to carry Fox News, and in the early days, alleviated a cash crisis by selling News Corp. shares to a company-owned Australian newspaper. But News Corp. is no Enron. I suspect that Chenoweth, a reporter for *The Australian Financial Review*, is yielding to a native journalistic predilection, "the tall poppy syndrome," under which journalists get high marks for cutting down major public figures. In Australia, few are as tall as Rupert Murdoch.

The book also has its share of errors. Chenoweth describes a heart attack that News Corp. General Counsel Arthur Siskind says he never suffered. Murdoch's supposed fall into a river during Herbert Allen's fabled media conference in Idaho is footnoted with the explana-

tion that "an alternative version of this story puts this incident in Alaska." With facts this slippery, it's difficult to accept the accuracy of conversations that, Chenoweth alleges, occurred as Murdoch and cable titan John C. Malone schemed to carve up the media world.

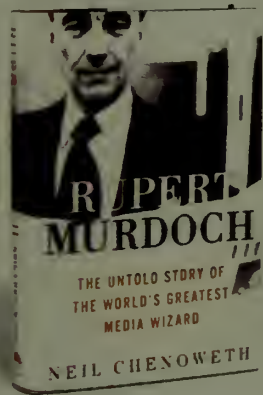
Chenoweth is on firmer footing when he turns to well-known events. A fluid writer, he recounts in sharp detail the 13 months of labor unrest that followed Murdoch's construction of a new printing plant for his British newspapers, laying off printers in the name of new technology. He impressively describes the tax-shelter countries that are home base to some of Murdoch's companies, and the use of arcane Australian accounting rules that made News Corp.'s assets more appealing to prospective lenders. And Chenoweth dazzles as he takes us through Murdoch's complex 1990 renegotiation of a \$1 billion loan that almost sent his company into liquidation.

The most riveting part of this book, however, deals with News Corp.'s supersecret News Digital Systems unit, an Israel-based outfit that provides encryption devices to secure programming on Murdoch's worldwide armada of satellite services. Here Chenoweth uses court documents to detail the illegal activities of British-born Michael Clinger, who ran the outfit for Murdoch and is now a fugitive on various securities violations. Not surprisingly, Chenoweth sees conspiracy. "What part of News Corp.'s management culture allowed it to employ a fugitive?" A good question, but not one that should be directed at Murdoch, who was clearly duped and is still trying to collect a \$56 million judgment awarded him by a London court that found Clinger guilty of overcharging Murdoch for the security devices.

Whatever bumps he faced, Murdoch continues to build his empire. He may soon get the U.S. satellite-TV service he has long desired. Federal regulators have rejected a sale of General Motors Corp.'s DirecTV service to EchoStar Communications Corp. If the company is again put up for sale, Murdoch says he may bid it. Of course he will.

BY RONALD GROVER

Grover is Los Angeles bureau chief.



CHENOWETH IS GOOD ON BUSINESS DETAILS BUT IS INCLINED TO SEE CONSPIRACY AT EVERY TURN

The BusinessWeek Best-Seller List

HARDCOVER BUSINESS BOOKS			LAST MONTH	MONTHS ON LIST
1	LEADERSHIP Rudolph W. Giuliani (Talk Miramax • \$25.95) <i>Hizzoner speaks.</i>	—	1	
2	GOOD TO GREAT Jim Collins (HarperBusiness • \$27.50) <i>How run-of-the mill companies make the leap to excellence.</i>	1	13	
3	RICH DAD'S PROPHECY Robert T. Kiyosaki, with Sharon L. Lechter (Warner • \$21.95) <i>Coming soon—a very big crash!</i>	—	1	
4	TAKE ON THE STREET Arthur Levitt, with Paula Dwyer (Pantheon • \$24.95) <i>The former SEC chairman on accounting sleight of hand and wise investing.</i>	—	1	
5	EXECUTION Larry Bossidy, Ram Charan (Crown Business • \$27.50) <i>Making strategies work.</i>	2	5	
6	THE ONE-MINUTE MILLIONAIRE Mark Victor Hansen, Robert G. Allen (Harmony Books • \$19.95) <i>Chicken soup for the investor.</i>	—	1	
7	NOW, DISCOVER YOUR STRENGTHS Marcus Buckingham, Donald O. Clifton (Free Press • \$27) <i>How to bolster your true talents.</i>	3	22	
8	MEMOIRS David Rockefeller (Random House • \$35) <i>The banker-statesman's life and times.</i>	—	1	
9	STRAIGHT TALK ON INVESTING Jack Brennan, with Marta McCave. (Wiley • \$22.95) <i>Vanguard Group's CEO on the fundamentals.</i>	—	1	
10	GLOBALIZATION AND ITS DISCONTENTS Joseph E. Stiglitz (Norton • \$24.95) <i>The IMF has failed, says a Nobel laureate.</i>	6	4	
11	THE FIVE DYSFUNCTIONS OF A TEAM Patrick Lencioni (Jossey-Bass • \$22) <i>Overcoming behavior that obstructs teamwork.</i>	10	6	
12	PRIMAL LEADERSHIP Daniel Goleman, Richard Boyatzis, Annie McKee (Harvard Business School • \$26.95) <i>Using "emotional intelligence" as a leadership tool.</i>	—	8	
13	CONQUER THE CRASH Robert R. Prechter Jr. (Wiley • \$27.95) <i>A depression is on the way.</i>	5	5	
14	DILBERT AND THE WAY OF THE WEASEL Scott Adams (HarperBusiness • \$24.95) <i>Scheming, manipulating, fudging, and other fun at the office.</i>	—	1	
15	FISH! TALES Stephen C. Lundin, John Christensen, Harry Paul, with Philip Strand (Hyperion • \$19.95) <i>Reel in more of the "Fish! Philosophy."</i>	12	7	

PAPERBACK BUSINESS BOOKS			LAST MONTH	MONTHS ON LIST
1	FAST FOOD NATION Eric Schlosser (HarperCollins • \$13.95) <i>The bad news on burgers.</i>	1	9	
2	THE TIPPING POINT Malcolm Gladwell (Back Bay • \$14.95) <i>What turns an idea into a hot trend.</i>	2	10	
3	REAL ESTATE RICHES Dolf de Roos (Warner • \$17.95) <i>Why buildings make better investments than stocks.</i>	15	12	
4	RICH DAD'S RETIRE YOUNG RETIRE RICH Robert T. Kiyosaki, with Sharon L. Lechter (Warner • \$17.95) <i>Plan ahead.</i>	3	10	
5	WHAT COLOR IS YOUR PARACHUTE? Richard Nelson Bolles (Ten Speed • \$17.95) <i>The 2003 edition of the enduring job-search bible.</i>	—	1	
6	THE RICHEST MAN IN BABYLON George S. Clason (Signet • \$6.99) <i>Save 10% of what you earn—then pay your bills.</i>	8	8	
7	THE E-MYTH REVISITED Michael E. Gerber (HarperBusiness • \$16) <i>A systems approach for small-business success.</i>	5	13	
8	THE 9 STEPS TO FINANCIAL FREEDOM Suze Orman (Three Rivers • \$13.95) <i>Learn to save.</i>	7	21	
9	LOOPHOLES OF THE RICH Diane Kennedy, C.P.A. (Warner • \$19.95) <i>Get the taxman off your back.</i>	—	4	
10	OWN YOUR OWN CORPORATION Garrett Sutton, Esq. (Warner • \$17.95) <i>The legal ins and outs of establishing a company.</i>	11	3	
11	THE ART OF POSSIBILITY Rosamund Stone Zander, Benjamin Zander (Harvard Business School • \$14) <i>How to be creative, by a psychotherapist and the conductor of the Boston Philharmonic.</i>	—	1	
12	THE POWER OF FOCUS Jack Canfield, Mark Victor Hansen, Les Hewitt (Health Communications • \$12.95) <i>Success without burnout.</i>	—	1	
13	HOW TO MAKE MONEY IN STOCKS William J. O'Neil (McGraw-Hill • \$12.95) <i>Picking winners, by the founder of Investor's Business Daily.</i>	9	6	
14	EFFECTIVE PHRASES FOR PERFORMANCE APPRAISALS James E. Neal (Neal Publishing • \$10.95) <i>Word power to help you rate your colleagues.</i>	—	1	
15	HOME BUYING FOR DUMMIES Eric Tyson, Ray Brown (Wiley • \$21.99) <i>Gimme shelter—and a mortgage.</i>	—	17	

LONG-RUNNING BEST-SELLERS

HARDCOVER BUSINESS BOOKS

WHO MOVED MY CHEESE? Spencer Johnson (Putnam • \$19.95)

FISH! Stephen C. Lundin, Harry Paul, John Christensen (Hyperion • \$19.95)

FIRST, BREAK ALL THE RULES Marcus Buckingham, Curt Coffman (Simon & Schuster • \$27)

RAVING FANS Ken Blanchard, Sheldon Bowles (Morrow • \$20)

PAPERBACK BUSINESS BOOKS

RICH DAD, POOR DAD Robert T. Kiyosaki, with Sharon L. Lechter (Warner • \$15.95)

GETTING TO YES Roger Fisher, William Ury, Bruce Patton (Penguin • \$14)

THE ONE MINUTE MANAGER Kenneth Blanchard, Spencer Johnson (Berkley • \$12.95)

RICH DAD'S CASHFLOW QUADRANT Robert T.

Kiyosaki, with Sharon L. Lechter (Warner • \$17.95)

THE 7 HABITS OF HIGHLY EFFECTIVE PEOPLE Stephen R. Covey (Fireside • \$14)

RICH DAD'S GUIDE TO INVESTING Robert T. Kiyosaki, with Sharon L. Lechter (Warner • \$19.95)

THE MILLIONAIRE NEXT DOOR Thomas J. Stanley, William D. Danko (Pocket Books • \$7.99)

BusinessWeek's Best-Seller List is based on a survey of chain and independent booksellers that carry a broad selection of books on economics, management, sales and marketing, small business, investing, personal finance, and careers. Well over 1,000 retail outlets nationwide are represented. Current rankings are based on a weighted analysis of unit sales in October. Titles that have been on the Best-Seller List for more than two years appear as Long-Running Best-Sellers.

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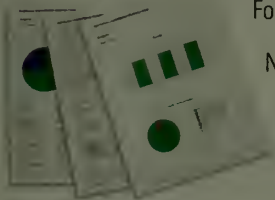
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STEPHEN H. WILDSTROM

h&you@businessweek.com

WIRELESS GIZMOS WITH FEWER STRINGS



GoodLink's server-based e-mail is more convenient and secure than PC-based services

Because the goal of this column is helping technology users help themselves, I generally stay away from products that require a hand from corporate tech staffs. But I've decided to bend that rule and take a look at GoodLink, a new system for delivering e-mail and other information wirelessly to mobile executives.

You can arrange do-it-yourself wireless mail delivery through a number of providers, including Research in Motion's BlackBerry, Handspring's TreoMail, and Sprint PCS's Business Connection. But these solutions, which relay mail from your desktop computer, have big shortcomings and pose security risks because they work only when a user is logged in to the desktop. If your office computer is a laptop that you take with you, the relay won't work. So when Good Technology (www.good.com) offered to set up GoodLink on my Microsoft Exchange server, I gave it a try.

Services such as GoodLink and BlackBerry Enterprise Server, which handle the wireless relay from a mail server, enhance the productivity of mobile workers. All desktop-based wireless relays let you read mail, but the best server versions let you avoid having to look at the same messages again on your PC: When you delete a message, it's gone for good, and you can move messages from your in-box to Exchange mailbox folders. GoodLink also displays attachments, including Microsoft Word and Adobe Acrobat documents and Excel spreadsheets, without any add-on software. Another GoodLink advantage: It synchronizes mail, contacts, and calendar items over the air. A BlackBerry needs to be placed in a desktop cradle for a full sync.

GoodLink runs over the same Cingular Wireless paging network as BlackBerry and, if you want, you can receive your GoodLink mail on a

BlackBerry 950 or 957 handheld. However, I recommend Good's own G100. The 4-in.-by-2½-in. unit, a bit smaller than the BlackBerry 957, resembles the RIM product closely enough that the two companies are tangled up in suits and countersuits claiming patent infringement. I found Good's controls and miniature keyboard both easier to use than BlackBerry's.

Unlike BlackBerry, the G100 doesn't offer a browser as an option, but that's no loss. Neither the device nor the network is designed for Web surfing. Instead, GoodInfo applications let you place inquiries about stock prices, weather forecasts, flight information, and the like and receive the results within minutes by return e-mail. A software development kit lets companies construct their own GoodInfo applications to query databases, customer-relations management systems, or other corporate data.

Despite the G100's strengths, Good, which began its corporate life making MP3 music players for Handspring handhelds, doesn't really want to be in the hardware business. The company plans

to offer its software services next year on Palm devices—such as the Handspring Treo and forthcoming Palm Tungsten W—that run on wireless-phone networks. A Pocket PC version is planned once Microsoft provides support for built-in key-

SMALL IS BEAUTIFUL
The GoodLink G100 device measures just 4 inches by 2½ inches



boards, probably in late 2003. Other mail providers, such as JP Mobile, Infowave, Synchrologic, and Wireless Knowledge, already offer wireless service to a variety of handhelds. RIM is moving in a similar direction: A recent licensing deal with Nokia could lead to a BlackBerry-like service on a

new generation of keyboard-equipped phones.

During a couple weeks of use, I found the GoodLink service to be a real time-saver. The contact and calendar functions, while not quite up to the level of a Palm or Pocket PC, were good enough that I felt comfortable with the G100 as my only data device, and continuous sync with Outlook was a huge plus. Good sells GoodLink through Cingular. The server software costs \$2,000, and monthly service starts at \$34.99 for 1 megabyte of data. The G100, available in quantity in January, is expected to be priced at around \$300.

Most mobile execs can profit from access to e-mail and corporate data wherever they happen to be. But wireless access makes sense only if it is secure, simple, and affordable. GoodLink looks like a winner on all counts.

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A man with glasses is shown in profile, working on a laptop. In the background, a large clock face is visible, with the number 12 clearly marked. The overall color scheme is a mix of green, yellow, and red.

real time enterprise

The Ultimate Synergy of
Business and Technology

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Creating Sustainable Competitive Leadership



Think of it as the "big bang" of business. Where the 1990's might be thought of as the Internet Age, this decade will be known as the Real Time Age. We are at a significant crossroad between what may be the ultimate synergy of business and technology. The quest for real time information processing finally may be within the reach of all companies – large and small.

A Real Time Enterprise (RTE) is a competitive business strategy that takes advantage of up-to-the-second and accurate information that is available for management, employees, suppliers, partners, and customers. Real time enterprises are highly adaptable. They can respond to changes in the marketplace as well as better predict those changes before they uncontrollably impact the business. A good way to think about an effective RTE is to measure its real control. Real time enterprises know what their customers need and deliver it proactively; they can close their accounting books in hours rather than weeks; and they can minimize the impact of process deviations caused by market changes, or even acts of God.

With the incredible economic pressure to reduce costs and improve productivity, today, more than ever before, companies large and small need to empower their entire organizations to make educated, timely decisions. Whether you consider the real time enterprise a revolution in concept or an evolution in technology, it is hard to argue that right now, every business needs to consider how making their operations work in real time can and will impact their viability.

Generation RTE

In today's connected world, computer literati prefer live chat over e-mail, and subscribe to chip-embellished credit cards to make online shopping even more convenient. Today, it is just as common to find a handheld device in someone's

briefcase than perhaps even a pen. Within the last decade, technology has made vast changes in our lives and expectations. Indeed, the last 10 years have tested the notion that patience is a virtue. We have become irreversibly a "zero-latency" culture.

Businesses need to have information on demand both for their customers and for the employees with whom they interact. They don't want to repeat their names, passwords, or other verification information to multiple company systems or people. Consumers will quickly go elsewhere if a company doesn't have the necessary information or product at the right moment. And what about investors who have been indelibly stung by the surprises of companies which are supposed to be in control of their operations? Despite advances in communications and automation,



We are at a significant crossroad between what may be the ultimate synergy of business and technology.

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real time enterprise

companies still do not (often, because they can't) report their financial positions until several weeks after the close of a quarter. Even if CEOs are held accountable for the accuracy of the reports, can they effectively do anything to improve the current position with only the available historical information?



If knowledge is power, real time information is the means for creating monopolies.

As we look forward in the short-term, it may be mandated by law for all companies to report their financial positions more frequently and closer to real-time. However, even without legal enforcement, companies that can close their books at the end of each business day will inevitably win investor confidence and subsequent wallet-share.

Soon, we'll be surprised to hear a customer service representative say, "Please hold while I access your records" or, "Let me get back to you on that," notes Barton Goldenberg, president of ISM, a company that specializes in real time product evaluations and industry consulting. "Building a real time enterprise is no longer a competitive advantage, but rather a means of survival. If knowledge is power, real time information is the means for creating monopolies."

Information technology (IT) and business strategy have long been evolving toward RTE. We know that having access and the ability to use timely, complete, and accurate information allows for more effective business decisions. However, like most enterprise-wide initiatives, this is much easier to say than it is to do. RTE depends on a lot

of technology, processes and cultural changes. These things must work together to generate, gather, distribute, and use information efficiently and securely. Perhaps, this has always been the IT end game, but now, we're seeing the real possibilities and urgency of businesses to commit themselves to real time initiatives. Peter Fingar, noted author and expert in technology and business said, "When information is recorded, it's history. While information is being created, that's the time it's really useful and actionable."

There are already a handful of successful real time enterprises being highlighted and examined such as Cisco, Fed-Ex, UPS, Dell, eBay and Walmart. Their stories relate how these companies have flourished by improving their inventory management, providing more flexible

and responsive customer interfaces, and enabling the entire organization to closely monitor and react to exceptions in their business processes. Like most visionary organizations, these market leaders made huge investments over long periods of time, to create information systems that provide critical and timely information to employees, customers, partners and suppliers. By employing technology in this way, they've created truly impenetrable barriers of entry into their markets by their competitors. One might even question whether their true competitive advantage is due to their product/service or their information systems. With these early adopter experiences and their successes in reaching operational excellence, other companies are now deploying real time initiatives with great urgency.

Real Time Retailing

Take for example, Sam Goody, a division of Best Buy Enterprises. Sam Goody is a leading home entertainment retailer selling music, movies and home electronics in most malls across the U.S. For many years, the

12 IMPERATIVES FOR A REAL-TIME ENTERPRISE

- 1 Standardize Business Processes**
It is critical that business processes be standardized across subsidiaries, geographies, and divisions.
- 2 Pure Internet Architecture.**
Extending business processes directly to customers, suppliers, employees, partners anywhere, from any Web device requires a Pure Internet Architecture.
- 3 Minimize customizations.**
Extensively customized packaged software becomes "customized software," with disadvantages.
- 4 Hold software vendors accountable.**
Implementation projects go better when the software company is engaged.
- 5 Accommodate multiple databases.**
Application software that runs only on one database is like buying a lamp and not the lightbulb to the lamp.
- 6 Highly scalable applications.**
With the potential of every customer, supplier, employee, and partner connected directly to business processes over the Internet, applications ultimately need to scale to millions of users.
- 7 Multilingual, multicurrency.**
Regardless of size, every company needs to have the capability to operate on a global basis.
- 8 Interoperability between vendor systems.**
Applications must be interoperable with multi-vendor and internally developed systems.
- 9 Embedded business analytics.**
Provide real-time insight to the customers, suppliers, employees, and partners who use the application.
- 10 Fewer vendors, broader product line.**
When business processes are online, you can't afford to have systems go down. Companies are selecting fewer vendors rather than continually integrating new applications from different vendors.
- 11 Change management.**
Moving business processes to the Internet will involve some change; anticipate a certain amount of change management.
- 12 CIO.**
You need a strong, decisive CIO to pull the team together and make things happen.

Source: Craig Conway,
President and CEO, PeopleSoft
Keynote Address, Digital Economy
Conference, December 2001

CREATING THE REAL-TIME ENTERPRISE

ORGANIZATIONS AROUND THE WORLD ARE DOING THIS TODAY

Organizations around the world are moving business processes to the Internet – and extending them directly to customers, suppliers, partners, and employees anywhere, anytime.

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The result is a real-time enterprise. The Real-Time Enterprise™ is transforming the way business is done. PeopleSoft® is uniquely positioned to help organizations drive this transformation. PeopleSoft customers are moving their business processes to the Internet with best-in-class applications – Customer Relationship Management, Supply Chain Management, Financial Management, and Human Capital Management – all supported by a Pure Internet Architecture™.

Organizations around the world are doing this today.

PEPSIAMERICAS relies on PeopleSoft CRM and Order Management systems to combine customer information across the enterprise and give real-time access to its telesales agents. "PeopleSoft 8 CRM gives a 360 degree view of our customers to the people in our enterprise who need it," says vice president and chief information officer Ken Johnsen. "The Internet architecture is easy to deploy, and that not only helps us lower our cost of ownership – it is also helping us get closer to our customers." As a result of operating in real time, PepsiAmericas not only knows its customers much better, but also has lowered costs by streamlining deliveries and enhancing customer satisfaction – ultimately increasing its competitiveness.

THE TEXAS EDUCATION AGENCY (TEA) deployed PeopleSoft SCA to optimize its \$40 million annual spend on the procurement of contract workers. TEA now has access to real-time data on supplier cost, quality and efficiency. And suppliers can be more responsive with online, real-time access to TEA's system. "We have more control of the contract services we manage and are capable of making smarter decisions," said Bill Monroe, TEA's COO. "We expect to save \$1 million per year – money that will go back into education."

DANSKE BANK uses PeopleSoft Enterprise Performance Management applications to allocate capital and manage risk in real time. "We can analyze our portfolios, determine potential earnings versus risk and flag unprofitable customers. With Internet architecture, it's relatively easy to link up databases and use PeopleSoft analytics on the front end to see the results," says Thomas Johanson, first vice president, Danske Bank. "PeopleSoft technology enables us to be more profitable and competitive in the global market. That alone is a huge return on investment that will give us a big competitive advantage."

HEWLETT-PACKARD worked with PeopleSoft to deploy a global HR solution from one location with instant access through any Web browser. "Our businesses are really screaming for real-time information about their performance," says Steve Rice, Vice President, Americas HR Functions and Shared Services. "Providing them with anywhere, anytime access to information will increase their efficiency and support their decision-making." All HP employees simply open a browser to use self-service applications. In addition to lower administrative costs, the simplicity and openness of the architecture contributes to IT infrastructure savings. Says Rice, "With PeopleSoft 8 HRMS, we'll immediately save substantial dollars in both IT and maintenance costs."

Dramatic Benefits

The performance benefits of operating in real time are dramatic. Operating costs are lowered. Accuracy is improved. Productivity is increased. Satisfaction is raised because customers, suppliers, partners, and employees participate directly in the business process.

For a multinational enterprise, Gartner Group estimates that between 30 percent and 60 percent of the total IT budget will need to be assigned to developing real-time capabilities. The opportunity to gain competitive advantage through real-time operations is the reason why. Organizations around the world are realizing tangible benefits today as they leverage real-time capabilities from PeopleSoft.

For a free copy of our brochure, "Building the Real-Time Enterprise," visit us at www.peoplesoft.com/real-time or call 1-888-773-8277.

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company has been building an inventory management system that enables them to monitor product stock levels in their stores and warehouses. Aside from the rather obvious benefits of ensuring that the necessary product is available for sale at all times (and not too much inventory taking up valuable space), they have built a complementary knowledge management system. This allows individual store managers to compare their own successes with that of their peers across the company's other 840 stores. With critical sales periods tied to time-restricted events like a new music release or a holiday, the windows of opportunity are small and can make or break the profitability of an individual store. The system can also instantly alert all personnel about competitive threats, such as the competition's latest sales and ads.

To help maximize these opportunities, store personnel can review, request, and submit selling tips through one of the several in-store systems dedicated to accessing the company's knowledge management Intranet. With these systems, local managers can quickly identify stores that are leading in sales on specific products or programs and then use them as showcases to help those stores



that are not doing as well. This allows the Sam Goody stores to share best practices and apply them quickly and effectively. "If we have target products or programs that we are incenting our staff to focus on, having the ability to monitor progress minute to minute allows us

to make adjustments as needed," concluded Ted Jirele, program manager for The Knowledge Management Group at a Best Buy Company. "By providing front line managers and store staff with time product and sales information, they can more effectively sell the right products and troubleshoot problems, while they can still make positive changes."

However, establishing real time hasn't come quickly or easily to the company. They have spent enormous amounts of time and money to build the technical infrastructure, operational processes and people skills needed to develop and use the information required. They ran several pilot programs before rolling out the program company-wide. The benefits, however, have far outweighed the challenges. The company is now realizing better inventory turn, higher employee and store productivity, and higher profit margins due to smarter selling and more responsive marketing. The bottom line has been the industry-leading success it has enjoyed in terms of sales and stock price.

Transforming Industries in Real Time

Clearly, the key benefit of real time is the ability to make faster and better decisions, since information is more accessible. For example, the ability to automatically replenish inventories when they are found to be low, to alert managers to shift sales strategies to those that are working and away from those that are not, or to quickly identify and efficiently fix a process that has gone awry. The tenets of an already established business/technology solution, Supply Chain Management (SCM), created a solid foundation for understanding how information about the relationship throughout a product lifecycle can dramatically affect the costs and profits of an organization. However, developing real time systems can, in fact, enable much more than that. As noted with Sam Goody, real time systems can enable collaboration that, in and of itself is invaluable, when the people and knowledge are distributed across various locations.



Australia-based Patrick Corporation is, in fact, made up of one hundred different companies. The company, a result of successful acquisitions, is now an \$800 million corporation that includes businesses that handle stevedoring, cargo transport, railways, auto transport, warehousing, and other port-related transport activities.

Patrick Corporation selected **PeopleSoft's** 8 system to

enable them to deliver real-time financial and HR information to managers on their desktops. Now, by using the PeopleSoft Enterprise Portal, they can provide information on human capital, financial issues, and asset utilization. Before, they would receive this information on paper only after the month-end processes were completed. As a result, duplication is also eliminated. "We're cutting transactions out," says Patrick's finance director, Robert Dunn. "That means our people can spend their time analyzing information, rather than just processing it." On the finance side, by standardizing common business processes, the corporation achieved world-class efficiencies in critical areas like financial and regulatory reporting. Month-end close times are down by an average 45 percent, with some of Patrick's businesses requiring only two days to close their monthly books.

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real time enterprise



laundry habits provide invaluable information to help plan and alter the laundry facilities, to accommodate demand and overall usage patterns. In this example, the use of real time is, in fact, transforming the way an industry works. Where only seven companies control the vast majority of laundry facilities, doing business in real time can be a critical competitive advantage. eSuds is proving that it can dramatically improve profits, as well as the customer experience and subsequent loyalty.

Is it Really Time for Real Time?

RT is coming of age at a time when confidence in business and management is at an all time low. People, specifically recovering investors, are demanding proof of both management's

Some argue that RT is enabled by the generation of PC literate workers and consumers who are "justifiably impatient."

Real time can also enable innovation. For example, eSuds, a division of USA Technologies, re-outfits laundry machines on college campuses with intelligent computer devices. The machines can send repair messages to the operators, when there is a problem or notify them when maintenance is due. Since a broken machine ceases to generate any money, getting a machine back online quickly is imperative. Additionally, students can view the availability of machines from their dorm rooms using an Internet browser to a dedicated Web site for that laundry facility. The system will also send e-mail notification to the student when the laundry is completed.

Detergent and softeners can be automatically dispensed for an additional fee, and best of all, the machines can operate in a complete cashless mode by using student ID or "Mobil Speedpass"-like devices. Not only is this system more convenient for the students, the operators no longer deal with the high theft rates of money being stolen from the machines. Individual and aggregated data stored about the students and their

operational control of the business and their reliable predictions of future performance. These requirements are driving organizations to implement new systems and measurements, often as a means of survival.

Most analysts will agree that the ability of an organization to be a real time enterprise has required an evolution of technology that has matured over time. Some argue that RT is enabled by the generation of PC literate workers and consumers who are "justifiably impatient." Bob Blumstein of research and consultancy firm IDC asserts, "Real time computing is as much about human psychology as it is about computing." Blumstein continues, "While there are the challenges today in helping people to know what to do with immediate information, the next class of business school grads will expect it."

Business schools have always taught the value of making timely, accurate decisions but rarely cited the inability of real-world managers to do this, because of limitations in IT. Often, people cite their biggest challenge in making fast

Stephen Brobst and Todd Wal

both CTOs at **Teradata**, a company specializing in creating active data warehouses, expressed that "the most critical aspect of implementing a real time enterprise is creating a single source of the truth – that is bringing all the corporate data into one place where it can be delivered appropriately to the people who need it, when they need it." By using an active data warehouse from Teradata, Union Bank of Norway (UBN) has been able to drive its customer relationship management strategy around event-based marketing. Event-based marketing is built on the simple idea that the best time to market to a customer is when the customer shows a need of interest. So, for example, when a customer places large deposits in his or her account, the time is right for some individualized follow-up for additional

savings or investment products. In the initial pilot program, UBN obtained a 60 percent conversion rate running event-based campaigns. They also believe that the solution will help cut costs because of more automated processes and the ability to use multiple channels



in their marketing approach. Reaction to the event-based marketing initiative from both UBN's customers and sales force have been positive. Sales have improved and the bank has cut time-to-market for its new customer-communication products.



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and accurate decisions is having information stored in disparate systems all over the enterprise.

However, data is only part of the overall real time puzzle. "Application integration remains one of the toughest challenges in today's IT environment," commented George Schussel, chairman and founder of DCI, a leader in high-technology education, trade shows, and management consulting. "On average, businesses have over 49 independent applications that need to be integrated, and they expect to spend over one third of their IT budget each year to do this." An entire industry focuses on application integration. Integration projects make up a critical share of revenues at such consulting groups as Perot Systems, Accenture, DWL, and IBM Global Services.

Application integration isn't a new problem, and there have been many major technology innovations that have tried to address it. By and large, these technologies were too proprietary and complex to be accepted industry-wide. Now, however, new vendor-neutral software standards are being accepted, which will allow application components built and running on

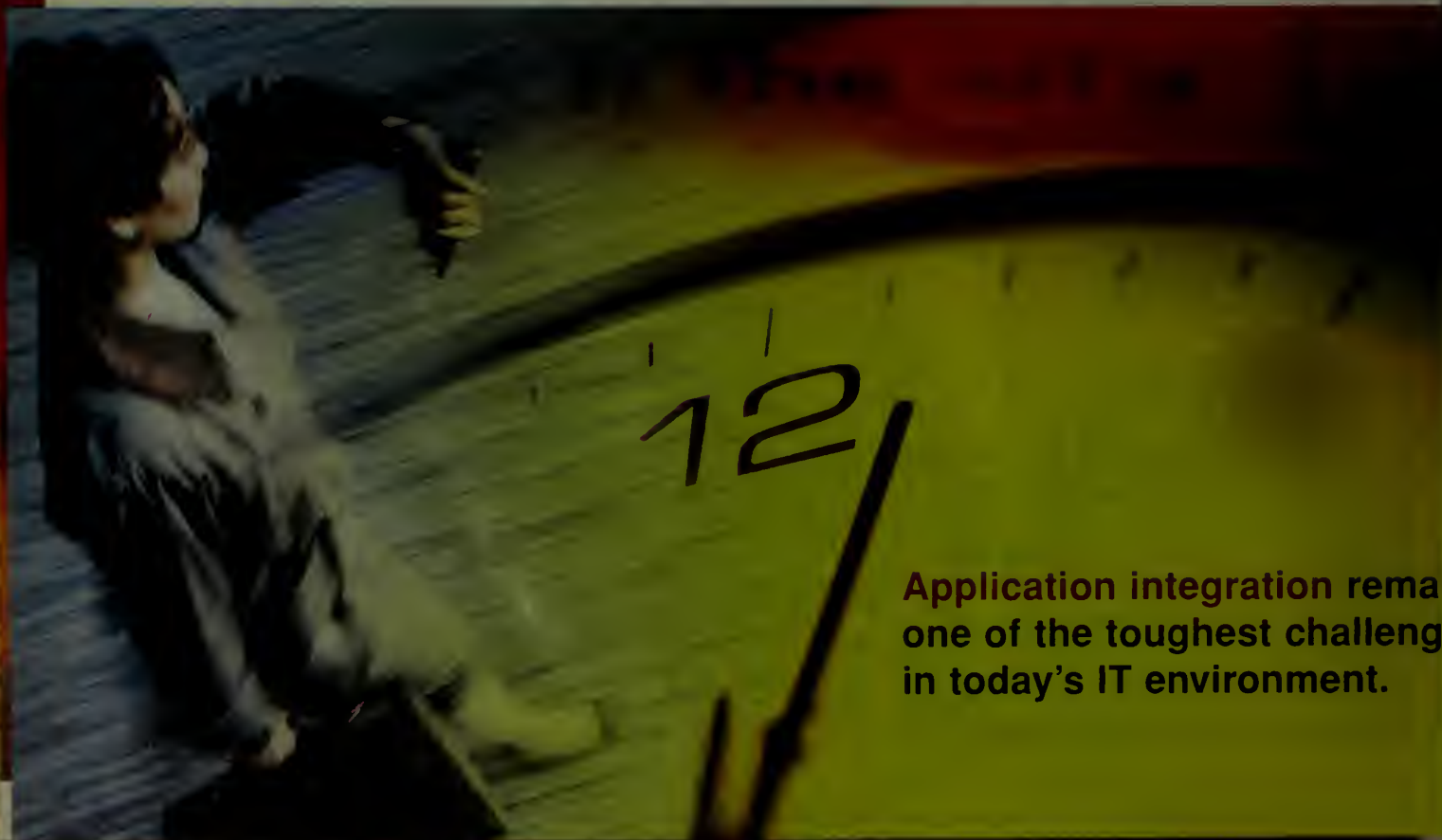
Working together, Hyperion Solutions Corporation and iSpheres provide a way for all decision makers throughout the organization to utilize real time information. Using iSpheres, employees can create alerts when user-defined thresholds are exceeded. For example, a person responsible for monitoring expense control might want to know when actual spending deviates more than 10 percent. Process control managers might want to be alerted when inventories exceed 5 percent of expected levels. iSpheres continuously monitors these rules and notifies the individual the second the threshold is reached, allowing them to respond immediately. Once discovered, the users can then use the Hyperion tools to further diagnose the cause and then deal with the exception more efficiently. "Real time is all about reducing the time between when an event occurs and when action is taken in response to that event," stated John Kopcke, Hyperion's chief technology officer. "We are moving from date-based planning to more event-based planning, which allows for much greater agility in a world where the competitive and economic landscape can change at a moment's notice."



different platforms, and performing different tasks, to more easily inter-operate. The new standards are aimed at building software components that are aptly called "Web services."

Like stereo components, the compatibility enabled by Web services allows software components to be interchange-

able. Built on the Internet foundation, Web services are the result of several new programming standards, such as SOAP, XML, J2EE, and .net. Software developers can build new systems using these standards and, in fact, "wrap" older, legacy systems, augmenting them with these standard interfaces so they



Application integration remains one of the toughest challenges in today's IT environment.



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can communicate with newer components. While software today is usually written in functional modules, the individual modules or components communicate between each other largely using proprietary protocols.

Web services provide a standard method of communication between these components that then allows the software components to share data and services without special translation. The goal is to be able to link internal and external online and offline processes, on-the-fly or in real time – in effect creating an automated software assembly environment in which systems are built and adapted as needed. This brings tremendous freedom to easily build and adapt IT systems that will allow businesses to be much more responsive to changes in their markets.

New software applications are also increasing the viability of implementing a real time enterprise:

- Management dashboards or cockpits are software programs like those in a car or plane, which present critical information in familiar formats that allow managers a hands-on way to diagnose and deal with business issues, *as they are happening*.
- Automated alerts can be sent to inform managers of deviations on threshold tolerances, or unexpected process exceptions.
- Packaged analytics software now being used goes beyond the traditional retailer needs to understand consumer behavior, to helping segment customers into appropriate catalog mailings or campaigns.

Today, these analytics tools, rooted in hardcore statistics, are being used to provide managers in any industry with predictive modeling capabilities to help predict what consumers (or competitors) are likely to do in the future. eSuds, for example, uses analytics to help determine what rules or thresholds should be set for maintaining their machines, by reviewing historical data coming in from all their existing machines. In this way, they can proactively maintain and service the machines to avoid downtime and subsequent loss of business.

• Collaboration is playing a key role in developing real time enterprises. Technologies such as shared Web sessions, live chat, instant messaging, and Webcasting allow distributed workers to collaborate and share best practices, as they are happening. These technologies can also be used to provide on-the-spot communi-

cations between customers and companies. For example, some banks are using collaborative technologies to support customers when they need help using the bank's Web sites for completing online applications, or for researching banking products. More than just helpful in their intent, these collaborative systems allow people to communicate easily and whenever needed. This ultimately brings untapped synergies to otherwise under-resourced organizations.

• Wireless technologies, including phones and handheld devices (such as Palm Pilots or Blackberry computers) can allow us to review information and receive critical alerts anytime, from anywhere. Wireless tags, sensors, and even something called smart dust will allow to monitor and control “virtually” any process – or as some fear, any people. Consider the idea of little LoJack devices



Pepsi Cola Buffalo Bottling Corporation,

one of the nation's top bottlers of Pepsi, sells and distributes Pepsi products in and around the greater Buffalo, New York area. The company's sales team and managers carry **Palm m505** handhelds loaded with route accounting software. Orders are entered directly onto the Palm handhelds, using previous customer orders as a starting point. “If your cus-

tomer typically orders 150 items, being able to call up the previous order and make changes as needed saves a ton of time,” said Dan Tantalo Jr., IT manager, Pepsi Cola Buffalo Bottling Corporation. Weekly ad sheets, digital photos, inventory reports and customer contact information are all available, as are Microsoft Excel spreadsheets and Word documents. Manual data entry has been eliminated, and route times have decreased by 1-1/2 hours. Sales reps now have 15 percent more time to service their accounts. The benefits:

- Productivity gains give sales reps 15 percent more time to service customers
- Out-of-stock inventory reports, updated every 10 minutes, ensure sales reps order available items for customers
- Digital photos of point-of-purchase displays encourage customers to leverage promotional materials, thereby boosting sales
- Mobile access to weekly ad sheets provides on-the-spot information for customers and shortens the sales process
- Elimination of bulky route books, files, and paperwork remove distractions and improve customer interactions

In many ways, the economy is fueling the need for RTE in forcing companies to cut back workers and find new ways to automate processes.

In everything from food, to pets, to children, to manufacturing processing. Some of this is already happening today. While it will be nice to have our refrigerator automatically order more milk when it finds your current supply low, how eager will we be to have our bosses know where to find us at all times?

Certainly, there is the question of how the current economic climate will affect the commitment or perceived urgency of RTE in the business community. "In many ways, the economy is fueling the need for RTE in forcing companies to cut back workers and find new ways to automate processes. In doing this, they are looking for ways to improve productivity and streamline decision-making," commented Bruce Richardson, senior vice president of research at AMR Research. "We are being challenged to 'decision re-engineer' our businesses so that we can convey a sense of urgency throughout the organization and on out to our trading partners. RTE enables us to do that, and we carefully monitor things to ensure that we remain knowledgeable and adaptive in the changing, complex marketplace."

Analysts also note that previous technology trends, such as supply chain management (SCM), enterprise resource planning (ERP), and customer relationship management (CRM), laid the groundwork to develop both back and front office processes. With the experience gained from these initiatives, organizations are now poised to integrate their own internal processes with those of their external partners and customers. As part of the technology evolutionary theory, the real time enterprise may simply be a matter of finally having all the technology pieces to deliver the right information, to the right people, at the right time.

"Much like the great Internet equalizer, companies deploying real time environments will soon pull away from the pack. Dragging behind them will be the vendors and competitors who missed the bandwagon. There's over \$1 billion in venture capital money being pumped into the RTE market already," noted ISM's Barton Goldenberg. "And in this tough economy, those companies already at the RTE forefront are weathering the challenges much better than those who are not."

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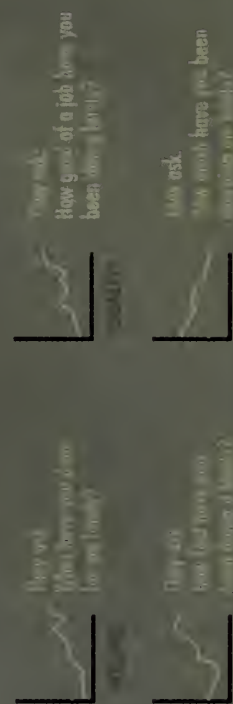
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The Challenge of Building a Real Time Enterprise

There are many challenges to building a real time enterprise, most specifically, identifying which areas of the business need better access to information, and how fast is fast enough. Like CRM and other enterprise-wide initiatives, we already know that real time implementations must be done in manageable bites that can quickly show a valuable return on investment. Not everything needs to be accessible in real time and it will be different for every business. For example, an obvious candidate for real time implementation would be a doctor, who would benefit greatly by being able to access patient information in real time. But supplying billing information to patients in real time might not be considered as critical.

The key to implementing a real time initiative is finding the business areas where faster access to information can



make a significant impact on the business objectives. Gartner's Ken McGee noted, "When deciding what systems and information need to be available in real time or not, it is important to evaluate what information is materially relevant. Information is materially rele-

vant when it will change your judgment or course of action, if it's available sooner than it currently is."

Dave Mosby, president of InterWorld Software Inc., a leading consulting company helping organizations define and design real time implementations stated, "The traditional functional approach design is focused on what work is to be automated or processes reinvented. Our approach is driven out of the answer to two basic questions posed to our clients. The first question is, 'What are the four key questions to which you need answers in order to know whether or not you've had good day?' The second question is, 'What are the questions which you need answers to produce the results for which you're responsible?'" Mosby continued, "When you consider the answers to these questions, you need to ensure that you are considering the value of real time delivery not only to the organization, but even more importantly, to the organization's customers."

But we know change is not always easy. The early adopters of RTE had little to use as a guide, nor proven technology to rely on. They had no choice, but to build proprietary systems in-house and act as their own system integrators. Now, with the confluence of new technologies and communication infrastructure such as Web services, wireless and the Internet, many believe that we can finally support the needs of a real time enterprise affordably, and with reasonable IT resources.

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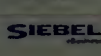
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Real Time, Real Changes

DCI's Schussel believes that the adoption of real time into our businesses will be "as important as oil was to the industrial age." Consulting giant, BearingPoint, Inc.'s Robert Lees, executive advisor, Asia and the Pacific, noted how aggressively many Asian companies are implementing real time initiatives throughout their businesses. The Japanese introduced the manufacturing paradigm "Just In Time Inventory," which had a sweeping global impact in both technology and business practices. Today, in Asia, we're seeing an urgency to have "Just In Time Information."

Average Efficiencies in Operating a Real Time Enterprise

- 30% Reduction in operating costs
- 23% Reduction in headcount
- 40% Increase revenues
- 35% Improved customer retention
- 37% Decrease in cycles times

Source: April 2002 NerveWire Survey of 162 Business and IT Executives

Europe's no-frills commercial airline, EasyJet, does dynamic pricing based on immediate availability and demand – and they are maintaining a significant edge, and gaining market share over

where a late decision is a *wrong* decision," concludes Peter Finger.

Experts agree we probably won't see the majority of businesses adopting the concept of RTE until 2005, however, all agree that those who are now making the commitment will be much better prepared to face the continued challenges of the shifting economy, future innovations and the changing demands of consumers. Call RTE a wave, a trend, or a strategy but do not mistakenly regard it as just another fad, or marketing buzzword.

RTE is the new way of life and a new way of thinking that soon will become as natural as the Internet or wireless phones. These technologies are all part of the grand scheme to automate our world, so that information will be as available and useful as water. Whether we'll see the impact of real time enterprises reaching cold fusion proportions, we can be sure that the Real Time Age will at least change the way we think, work, and live.

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RTE is the new way of life and a new way of thinking that soon will become as natural as the Internet or wireless phones.

Where some Asian countries lagged behind previous technology waves, now, many want to leap way ahead by implementing real time strategies. For example, in China much is written about both the manufacturing and financial services industries utilizing real time principles to help achieve large efficiencies and improve product management. However, the public sector is also a main focus for completely re-implementing solutions to enable faster access to information and better customer service. China, along with some of its neighbor countries are benefiting from a huge influx of new global capital, much of which is helping to fuel a very aggressive real time corporate and governmental movement.

It's clear that the real time enterprise is, indeed, real and happening now.

larger, more entrenched rivals. Nationwide retailer, The Limited, uses early postings of east coast sales data to alter west coast merchandising, taking advantage of the three-hour time difference. IBM claimed cost savings of more than \$1.5 billion in 2000, with the introduction of its Web-based customer assistance to its U.S. call centers.

GE estimates its digitization initiative saved \$1.6 billion in 2001. And the list continues to grow each day as companies – whether forced by law and business conditions, or simply striving to dominate their market niche – continue to push forward in delivering appropriate real time information. "Real time is all about having enough time to make an effective decision and act, and

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BY LAURA D'ANDREA TYSON

GOOD NEWS FOR JOE TRUSTFUND, BAD NEWS FOR JOE SIXPACK



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tax cuts
go to the
wealthiest
1% of
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And the GOP
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The economic prospects for average Americans are deteriorating. Unemployment is rising, job insecurity is increasing, personal income growth has stalled, health-care costs are soaring, pension values have plummeted, and states are cutting back on education, transportation, and other services while hiking real estate, sales, and income taxes.

Not surprisingly, in the weeks leading up to the midterm elections, the economy was No. 1 on the minds of voters, outpolling both terrorism and Iraq. The economy's faltering performance should have made it an easy target for the Democrats, but they failed to unite around a compelling economic message. Buoyed by the President's personal popularity, the Republicans won a decisive congressional victory. Now, the President is going to put his economic agenda to work. Unfortunately, it isn't an agenda that represents the interests of the average American.

In sharp contrast to the Democrats, President George W. Bush has been unambiguous about his economic priorities. Tax cuts, along with large increases in spending on national security, top the list. Fiscal responsibility comes in a distant second. And the tax cuts that matter most to Bush, such as the elimination of the inheritance tax, are those that benefit the very rich. You won't hear the President suggesting a temporary payroll-tax reduction for middle- and lower-income workers to stimulate the economy despite the fact that three-quarters of working Americans pay much more in payroll taxes than they do in income taxes. Nor will you hear him recommend federal grants to the states to help them cover the costs of their educational and social services during a period of austerity. Instead, you will hear him reiterate his demand to Congress to make his tax cuts permanent, perhaps even accelerating reductions in the top income tax rates that have not yet taken effect. But he certainly won't mention that by 2010, about one-half of the total benefits of his tax-relief package will go to the wealthiest 1% of taxpayers. And he won't reveal that three-quarters of the modest tax breaks for the average Americans in this package have already occurred.

The Bush economic agenda is also unabashedly pro-business. Despite the brouhaha over corporate malfeasance, the President has already scaled back his request for additional funding for the Securities & Exchange Commission, making it more likely that future infractions of the nation's securities and accounting laws will go undetected and unpunished. And his plan to reduce America's

dependence on foreign sources of energy include granting generous tax relief and coveted exploration rights in Alaska's Arctic National Wildlife Refuge to big energy-producing companies while slashing support for conservation and the development of alternative energy sources.

Nowhere is the President's pro-business stance more transparent than in his proposal for a prescription-drug benefit for Medicare. There's little doubt that a drug benefit is sorely needed. Prescription-drug costs are the fastest-growing component of health-care expenses. A third of the elderly has no drug coverage at all, and many of the rest are inadequately covered. The President proposes to address this problem by providing subsidies to private insurance companies—a major source of campaign donations to the Republican Party—to offer prescription-drug policies. This approach is destined to fail. Despite the lure of subsidies, few insurers will be tempted to offer such coverage at affordable prices because they know that the elderly Americans most likely to purchase it are precisely those elderly Americans who have the greatest need for expensive medicines. In contrast with the Republican approach, a Democratic plan would add a prescription-drug benefit to the Medicare program. The Democratic alternative is opposed by both the insurance and pharmaceutical industries and would cost substantially more than the Republican plan. But the Democratic proposal would work—and savings from canceling Bush's future tax cuts for the wealthiest Americans could cover its costs.

Then there's the issue of Social Security, which is still the single largest component of retirement income for 80% of the nation's elderly. If the President's tax cuts do become permanent, their total magnitude will be more than double the size of the deficit projected for Social Security over the next 75 years. The President has chosen to use the temporary surpluses of the Social Security system to finance tax breaks that disproportionately benefit the wealthy rather than bolster the system's long-term solvency.

The President has clearly identified his economic priorities. The Democrats need an equally straightforward response. They should not espouse big government, nor should they preach rigid commitment to balanced budgets and debt reduction, regardless of the state of the economy. Instead, the Democrats should focus on fairness: a message that will resonate with the average American whose economic interests are not being served by the President.

Laura D'Andrea Tyson is dean of London Business School.

BY JAMES C. COOPER & KATHLEEN MADIGAN

ROUGH PAVEMENT NOW, BUT NOT DOWN THE ROAD

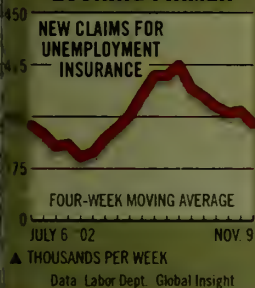
Beyond this quarter, expect the economy to make solid gains

U.S. ECONOMY

The mixed bag of economic data in recent weeks, while difficult to sort out, makes one clear point: The stutter-step recovery is stumbling once again this quarter. Compared with the third quarter's solid growth rate, which appears to have been higher than the Commerce Dept.'s first estimate of 3.1%, growth this quarter is struggling to make it into the plus column.

But the present is not prelude. Nothing in the numbers suggests the current quarter's weakness will carry over into the first quarter. It's just the opposite. This quarter's "soft patch," as Federal Reserve Chairman Alan Greenspan puts it, is a temporary downdraft from a host of one-shot problems, including labor disruptions at West Coast ports, a backtracking in car sales after an incentive-driven surge, and the summer slump in stock prices, which have since rallied. The uncertainty of war worries is also a big negative.

JOB MARKETS ARE LOOKING FIRMER



Fourth-quarter growth, in terms of real gross domestic product, will look disappointing, mainly because the downdraft hit in September and October. That creates some depressing math for the fourth-quarter GDP data, since many measures of demand and factory output are starting this quarter at very low levels compared with their third-quarter averages. Even if the monthly data for November and December look good, a weak GDP showing is already baked in the cake.

However, remember that solid fundamentals under consumer spending and firmer supports under business outlays assured that third-quarter growth would bounce back after slumping to 1.3% in the second quarter. Now, looking to the first quarter, those fundamentals are getting stronger: Confidence is rebounding. Labor markets are stabilizing (chart). Profits are picking up. And the Fed has taken out some recovery insurance with its aggressive cut in interest rates on Nov. 6, which was aimed at reducing uncertainty.

REPORTS FROM THE BUSINESS SECTOR

are showing the effects of the summer's events. Manufacturing has been hit especially hard. Industrial production fell a steep 0.8% in October, the third decline in a row

and the largest since the economy was in recession last year. But the numbers need to be read carefully. About half of the monthly output loss reflected falling auto production, which was depressed by parts shortages resulting from the port shutdowns on the West Coast from Sept. 29 to Oct. 9.

More important, indicators of demand, including factory orders and consumer spending on items other than autos, have not fallen off commensurately with output. And producer prices at the crude and intermediate stages of production are rising, another sign of firmer demand. This suggests factory activity will rebound in coming months.

Even so, one disturbing item in the output data was a second straight drop in the production of business machinery, down 1.5% in September and 2% in October (chart). The stock market plunge and war worries undoubtedly led to the tabling of some spending plans.

Still, these recession-size drops came suddenly after four months of modest improvement, suggesting other factors, including the dock situation, were at work. Indeed, through September, the trends in both capital-goods orders and shipments have held up. And the output of high-tech gear has increased every month so far this year. It's up nearly 15% from a year ago.

The port troubles are also skewing the GDP math for foreign trade. Dockworkers began a work slowdown in September, causing imports and exports to fall, and the trade deficit narrowed to \$38 billion from \$38.3 billion in August. The October gap is likely to shrink again, as the full impact of the port-related distortions reaches the data. But ships are now being serviced, so imports and exports will look stronger in November and beyond. To the extent that imports outpace exports, trade could be a drag on this quarter's GDP growth.

WHILE THE SUPPLY SIDE of the economy is signaling weakness this quarter, the demand side, especially in the consumer sector, suggests that momentum is building, which should carry the economy upward in 2003.

Consumer spending may not look too resilient, given the flat performance of retail sales in October. But

CAPITAL-GOODS OUTPUT TUMBLES SHARPLY



Business Outlook

that reflected the plunge in vehicle sales after auto makers removed the summer's generous financing deals. That falloff is why real consumer spending will be extremely weak this quarter, compared with its 4.2% annual rate increase in the third quarter.

Excluding cars, however, October retail sales jumped a larger-than-expected 0.7%, proving that households have not thrown in the towel (chart). The gains were broad-based, including a 4% jump in apparel sales and a 1.4% gain in nonstore retailers, mostly catalog and Internet retailers.

Consumers are continuing to shop because incomes are still growing well above the pace of inflation. Consumer prices rose 0.3% in October, or 2% over the past year. That rate is below the 3% yearly gain in hourly pay last month. Consumer buying power is also getting a boost in November, since gasoline prices are falling again, as prices of crude oil have declined more than \$4 per barrel since the end of September.

IN ADDITION, the University of Michigan's index of consumer sentiment bounced back in late October, indicating households may not be as worried about job prospects or their stock portfolios. The declines in unemployment claims suggest the job markets have stabilized, and the latest survey from Manpower Inc. shows that companies plan to increase hiring in the first quarter. Plus, from Oct. 9 until Nov. 19, the stock

market was up 16%. Those positive trends in income, labor markets, and wealth are evidence that consumer fundamentals are still very solid.

Despite the consistent gains in consumer spending, though, businesses have been cautious in stocking their inventories. Business inventories increased 0.5% in September, the biggest rise in almost two years, but that may reflect businesses stocking up on imports before the dock troubles boiled over. Much of the gain reflected recent ups and downs in auto inventories. Given the solid gains by nonauto retailers in October, inventories remain very low relative to sales. With little merchandise on hand, businesses will have to reorder soon—another reason to expect production to pick up in the first quarter.

A split between spending and output trends is not surprising new, but it's crucial to remember that the dichotomy always resolves itself in one way: Barring a drastic change in fundamentals, as demand marches along, it will eventually carry production along with it. So while the economy is teetering this quarter, it will right itself by the first quarter, and the ride will be a whole lot smoother then.

WHERE STORE SALES ARE STILL CLIMBING



ITALY

HELP IS NOT ON THE WAY

The dimming euro zone outlook turned even darker on the latest dismal news about Italy's economy. The zone's slowdown reinforces the idea that any monetary stimulus will be too late.

Italy's real gross domestic product in the third quarter grew 0.3% from the second quarter, or only 0.5% from a year ago. The fourth-quarter performance will probably look worse, given the recent monthly numbers. Industrial production fell 0.5% in

September, and the employer trade group Confindustria says October output slipped another 0.3%, although factory orders in September rose 0.5%. Business sentiment dropped in October,

while consumer confidence last month hit a five-year low.

Consumers are increasingly worried about job prospects. Although the third-quarter unemployment rate fell to 8.7%, recent

layoff announcements, most notably by auto maker Fiat, weaken the job outlook. That could cause consumer spending to soften, leaving real GDP growth for the year up only 0.4%.

The Bank of Italy is far more optimistic for 2003. In its annual bulletin, released on Nov. 18, the BOI said the economy could grow 2% next year if the government finally moves forward with infrastructure projects.

That fiscal criterion, however,

runs up against two problems. First, Prime Minister Silvio Berlusconi has concentrated on tax cuts rather than increasing spending to boost the economy. Second, Italy's fiscal debt situation remains one of the worst in the 12-nation euro zone. The federal deficit is expected to equal 2.4% of GDP this year, making it very unlikely that Italy will hit the European Commission's target of a balanced budget in 2004.

The recent slowdown in economic growth in the euro zone has raised expectations of an interest-rate cut by the European Central Bank, perhaps as early as its Dec. 5 meeting. But given the time lags between rate cuts and economic pickup, the ECB's action won't help the economies of Italy and other euro zone members until perhaps the second quarter of 2003. ■

CONSUMER CONFIDENCE HAS HIT THE SKIDS





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TIDINGS OF...

Retailers are playing it safe. That could backfire if shoppers splurge

Adrianne Kalyna is the kind of shopper that retailers dream about, especially in this year of economic ambiguity. The 44-year-old executive recruiter expects business to slow at her Chicago firm. Her investment portfolio is down 40% and she doesn't see a turnaround anytime soon. Yet Kalyna still expects to spread plenty of holiday joy. She plans to spend about \$2,000, mostly on her teenage son. Says Kalyna: "You can't have a doomsday attitude for Christmas."

Plenty of retailers don't share her optimism. Fearful of a weak economy, rising unemployment, and such unknowns as the prospect of war with Iraq, most are hunkering down for another rough holiday season even as they're still smarting from a disappointing back-to-school season.

Making matters worse, white-knuckled shopkeepers are getting little hint

from consumers that the Christmas season will turn out better than they think. Although shoppers like Kalyna helped send retail sales, excluding autos, up a surprisingly strong 0.7% in October, sales slowed in early November as buyers deserted the stores.

With such shifting winds, it's no wonder that anxious retailers fear the worst. They have so lowered their expectations that the modest 4% rise in sales of general merchandise predicted by the National Retail Federation would come as a relief. Certainly, no one is counting on seeing a repeat of the 5.6% rise that they posted last year.

The result: Pessimistic retailers are in their most defensive, cautious mood in years. They've thinly stocked shelves and kicked off a more aggressive than the usual round of preholiday sales in an attempt to lure shoppers. And don't look for anything radically new or different on display. "We're planning it flat," warns Gerald R. Szczepanski, chief executive officer of teen retailer Gadzooks Inc. "I don't see there's anything really encouraging going on in the economy."

That strategy may yet prove right. Certainly, no one wants a replay of last year's mess, when overstocked shelves still brimmed with unsold toys and gifts on Dec. 26. To avoid that mistake again, retailers are cutting way back on inventories this year. In September, they had less than one and a half months of merchandise on hand, ac-

cording to the U.S. Census Bureau. That's down about 4% from inventory levels of last year. For department stores the conundrum could be particularly vexing. Inventories of both Federated Department Stores and May Department Stores are down nearly 5% from last year's levels. Their game plan is to boost profits by selling more goods at regular price, instead of last-minute markdowns.

Yet, there's a risk: If retailers have gauged shoppers wrongly and Christmas sales prove stronger than expected, stores may be caught badly short. Rather than cashing in on demand, retailers could find themselves with empty shelves when they might have been reaping profits. Retailers' conservatism "could turn out to be a self-fulfilling prophecy," say

WHILE IT LASTS!

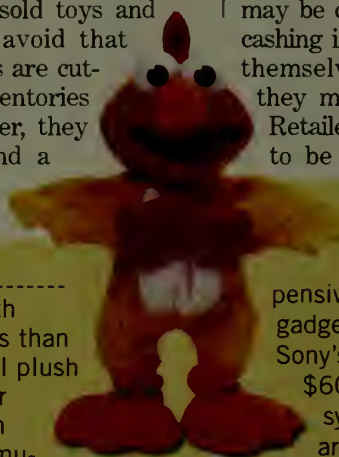
Retailers have scaled back their expectations—and their inventories—for the holiday season. Some shoppers have been hitting the stores early to make sure they score this year's hot items:

Data: NPD Group, Consumer Electronics Assn.



TOYS

Toys come packed with more fancy electronics than ever. Hasbro's FurReal plush cats purr and snarl for \$35; Mattel's Chicken Dance Elmo flaps to music. Harry Potter games and Yu-Gi-Oh trading cards are big sellers. So are edgy graphics-rich video games such as *Grand Theft Auto: Vice City*.



CONSUMER ELECTRONICS

Buyers are flocking toward inexpensive DVD players—along with price gadgets that go with them, such as Sony's \$2,500 wide-screen TVs and \$600 "home theater-in-box" speaker systems. Shutterbugs are snapping up \$299 printers for digital photos.



consumers with coupon mailings. They have no choice. "People are much more hesitant to make purchases when there are no markdowns or coupons available," says Lisa Routh, an Atlanta sales associate at Rich's Department Store, a unit of Federated.

Internet retailers, too, are counting on bargains to build their 3% share. From Amazon.com to Yahoo! to eBay, online sellers are pushing discounts and offering free shipping. Along with free delivery on orders over \$25, Amazon has marked special deals on toys, some more than 60% off list price. Yahoo! Shopping, which hosts 13,000 merchants,

MALL CRAWL: Shoppers are holding out for bargains—and everyone is accommodating them

has launched a department that highlights such bargains as a \$49

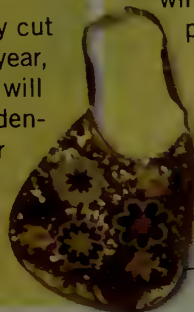
endy Liebmann, president of WSL Strategic Retail, an industry consultancy. Indeed, there is fresh evidence that shoppers could loosen the purse strings more than expected. Along with the October sales boost, consumer confidence has been growing lately. The University of Michigan's much-watched confidence index rose some 5% in early November from the prior month. "It won't be good as last Christmas, but it won't be a disaster," says Arthur C. Martinez, former CEO and chairman of Sears, Roebuck & Co.

Not all store chains, of course, are gloomy. Discounters such as Wal-Mart Stores, Target, and Kohl's will probably be the best of all. A Nov. 12 survey by consultant Deloitte & Touche found that 71% of consumers will make such

APPAREL

Shoppers will probably cut back on clothes this year,

but much of what they do buy will be rolled-up. Two likely winners: a denim jacket with a faux mink collar for \$19, from J.C. Penney, and gold purses embellished with floral patterns, offered by H&M for \$19.



price-cutters their top choice. And the big toy chains are hopeful that while mom and dad may cut back on other parts of the family budget, they'll continue to splurge on toys for junior. "They didn't spend it in August and September," says Toys CEO John H. Eyer Jr. "Will some of that come back into the holiday? We think it could, particularly spending on children."

Even before the traditional Thanksgiving kickoff for holiday shopping, higher-priced outlets, wary of being left out, have been feeding appetites for bargains. Outfits such as Federated Department Stores Inc. and May Department Stores Inc. have been launching a series of one-day sales and flooding

HOUSEHOLD PRODUCTS

Need a set of hand-etched glassware? Or an antique-looking wine bucket? With gear for inexpensive home entertaining topping many Christmas wish lists, Pottery Barn will sell you both for under \$50. Retro is also back: Restoration Hardware's 1950s-style clock radio/CD player goes for \$150.



DVD player and \$29.50 Polo Jeans Co. T-shirts. "Value shopping is a huge trend," says Rob Solomon, Yahoo's senior vice-president of commerce. eBay has seen a boom in toy listings, which it credits to early promotions and a big brand-marketing campaign.

Back at the mall, conventional retailers have been rushing to pack shoppers in early in part because the shopping season is six days shorter than usual. That leaves less time to move such hoped-for hits as Chicken Dance Elmo, Mattel's \$20 retread of the popular Sesame Street character. The shorter season is partly why toy sales overall are expected to be flat, at just around \$25 billion this year, according to market research firm NPD Group.

No sector faces a bigger challenge than consumer electronics. After a year of steadily declining prices for DVD players, chains such as Circuit City Stores Inc. and Best Buy Co. hope to persuade video fans to pony up for such higher-margin gear as digital plasma TVs and home-theater sound systems. But that's a risky strategy. The market has become increasingly competitive as Wal-Mart and Target and even Gateway Inc. dive in. One of the few hot spots for electronics

retailers: video games. Sales are projected to climb 10% this year, to \$10.4 billion. Doing particularly well are highly theatrical games aimed at adult players such as Rockstar Games' *Grand Theft Auto: Vice City*, which has voiceovers from movie stars such as Ray Liotta and Dennis Hopper.

No such similar fallback exists for the beaten-down apparel industry. More than other sectors, apparel has cut inventories to the bone—down 6.5% from year-ago levels, says NPD Fashion World co-president Marshal Cohen. Still, in an attempt to create some fashion buzz, both discount and upscale chains are offering clothes and accessories gussied

up with sequins, faux fur, and coin-like metal trim adorning belts and purses. Will they pay off? Probably not. Analysts at U.S. Bancorp Piper Jaffray figures apparel sales may rise as little as 0.9%. The problem: "There's no apparel equivalent to the Cabbage Patch doll," says Emanuel Weintraub, a Fort Lee (N.J.) management consultant.

Of course, not all retailers are slashing inventories on the bet that the season will be a flop. Outfits such as Toys 'R' Us and clothing-store chain Kohl's Corp. are laboring mightily to carve out a bigger share of their respective pies. Toys 'R' Us is carrying a lot more likely hits and fewer losers. Execs say they are in good

shape so far. Hot toys are in stock 97% the time this year, up from 65% in the 1999 holiday season. And Kohl's has added clothing racks packed with name-brand casual clothing on the bet that shoppers won't be able to find what they want in department stores.

It's a long shot. But weary of political and economic gloom, shoppers could be right to splurge. If that happens, retailers who have skimped on stocking up will be crying in their punch.

By Robert Berner in Chicago and Christopher Palmeri in Los Angeles, with Louise Lee and Robert D. Hof in San Mateo, Wendy Zellner in Dallas, Nancy Byrnes in New York and bureau reports

THE TOY THAT'S LEAPING OFF THE SHELVES

Five-year-old Alexia Hernandez has already mastered letters and numbers, and mother Michele thinks she knows why:

Alexia has a LeapPad, one of the hottest-selling high-tech educational toys. "She thinks it's so cool and has learned so much

SOUNDS OF MUSIC: The LeapPad

from it," says Hernandez, a college admissions consultant in Lake Oswego, Ore. She says the toy, which emits sounds and music when kids point to pictures, numbers, and letters with a stylus, also has helped Alexia improve her hand-eye coordination and attention span.

Reviews like that have got business hopping at LeapFrog's maker, LeapFrog Enterprises Inc. in Emeryville, Calif. The ticket to a hot Christmas, says CEO Michael C. Wood: toys that make kids "squeal with delight but also help them learn a lot." LeapFrog is projecting a holiday-quarter sales jump of as much as 30% over last year, to \$200 million, and a profit increase of as much as 86%, to \$21.6 million. Its products account for 7 of the 15 top-selling toys at Amazon.com Inc.

LeapFrog has come a long way in seven years. Wood, searching for a

way to teach his son phonics, started the outfit in 1995. Two years later, he sold it to Knowledge Universe Inc., a holding company founded by financier Michael Milken and Oracle Corp. chief Lawrence J. Ellison. Sales have flown ever since, based largely on the LeapPad product. They should hit about \$480 million this year, up from \$31 million in 1998. The company went public in July, and its shares have since bounded 79%.

Now, LeapFrog is being touted as one of the rare bright spots in the \$25 billion toy industry. Driving the company's success is its core LeapPad line, designed for children three and older. The basic \$40 LeapPad looks like a notebook PC from the outside. Folded inside, though, is a kid's book and a stylus. Touch the stylus to the page, and the gadget reads stories out loud, identifies the sounds of musical instruments, and guides

tots along on basic addition.

To keep parents buying, the company is working on new software and book inserts to upgrade the pads as kids grow older. LeapFrog now sells five such titles at about \$15 each for every LeapPad, up from two a year ago. In each successive version, math, reading, and music lessons become increasingly challenging.

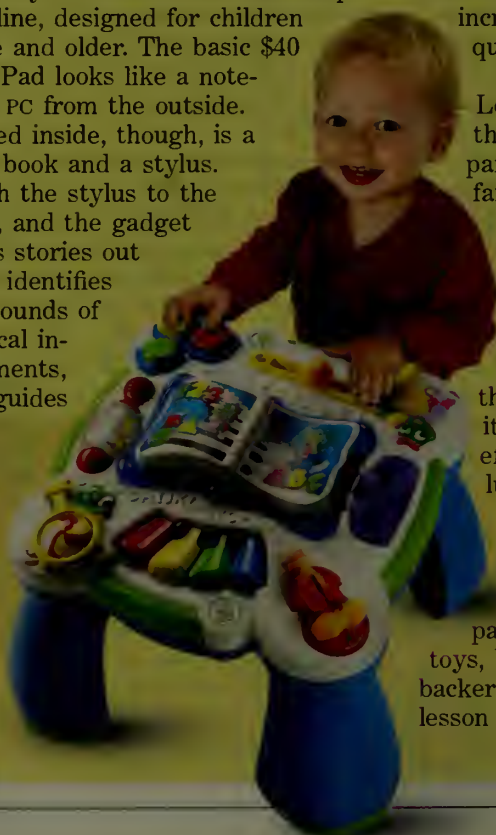
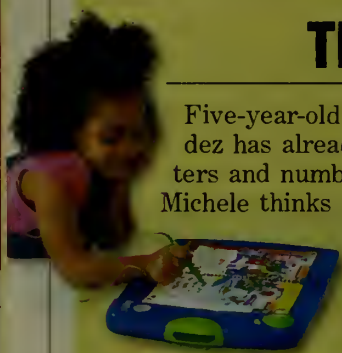
Those upgrades are key to LeapFrog's future success. Sales growth is slowing now that most retail outlets already offer LeapPads. The 30% projected sales gain for the fourth quarter is down from a 76% increase during the first three quarters.

And not everyone is singing LeapFrog's praises. Critics say the company is just preying on parents' fears that kids will be failures without the latest "educational" gizmo. Toys such as the Leap-Start Learning Table "might help keep your kid away from

the junk on TV, but if you think it'll have anything but a minor effect academically, you're deluded," says Jonas Langer, a psychology professor at University of California at Berkeley.

Perhaps. But as long as parents keep buying LeapFrog toys, Wood and his well-known backers will enjoy the kind of math lesson investors like best.

By Louise Lee in San Mateo



AMERICAN'S ATEST TEST FLIGHT

Will fewer fares and more business bargains lift the carrier?

A decade after rocking the airline industry with an effort to simplify fares, American Airlines Inc. is at it again. On Nov. 14, it quietly kicked off a test of a new, streamlined fare structure: It has slashed walk-up coach prices by 40%, while at the same time hiking some leisure fares on those routes.

But unlike American's so-called Value Pricing effort in 1992, this test isn't likely to lead to crippling fare wars. This time, the nation's largest airline is moving cautiously in a mere 23 domestic markets, many of which American dominates, such as Dallas to Los Angeles. That, airline experts say, should limit retaliation for now. Still, the experiment, closely watched by competitors, could prove to be a watershed in the industry's efforts to return to financial health. With airline losses likely to top \$7 billion this year, all the big carriers are scrambling for ways to slash costs and boost revenues. Delta Air Lines on Nov. 13 unveiled a new low-cost "airline-within-an-airline" to take discount carriers head on. But few have been brave enough to make drastic fare moves for fear of sparking an industry bloodbath.

What's behind the fare changes? Demand from business passengers who have been clamoring for years for a simpler, more fair system. So American is slashing the priciest coach fares while at the same time raising prices on some restricted tickets. It's also collapsing more than a dozen fares per market to just five or six. It hopes the change will boost revenues by stimulating more business travel in a severely depressed market. But it must also persuade passengers who buy the cheapest restricted fares to pay for higher-priced, more flexible tickets.

Will the discounts be enough to tempt more business travelers? Many already pay far less than the posted business fares, thanks to corporate discounts, lower advance-purchase prices, and discount carriers. American Express Co.

calculates that the typical one-way business fare was \$572 in the second quarter, while the average fare actually paid by business travelers was only \$273. But those cheaper fares sometimes come with circuitous routings or restrictions.

American's move also may not win much favor from leisure travelers, who already enjoy rock-bottom fares. And it could be easily undercut by rivals. The 30-day advance-purchase prices in American's new fare scheme are typically 10% to 15% higher than what customers can already snag in sporadic fare sales, says

estimated 10% to 15% revenue gain on those routes. Delta refuses to comment.

America West Airlines Inc. led the pack with its own fare-simplification efforts last March, including cutting walk-up business fares on its entire system by 60%. The result: more business fares sold and higher revenues. Its revenue per passenger mile flown is now about 85% of the industry average, vs. 75% to 80% before the change. But smaller America West could afford the risk since it sold few full-fare tickets to begin with. It also didn't have to worry about attracting the same kind of retaliation that giant American could.

Whatever the result for American, business customers and travel agents alike say the fare overhaul is a step in the right direction. They have long called for a vast reduction in the gap between business and leisure fares. American Express says business tickets on average are now six times the lowest



American Shakes Up Prices

It's slashing hefty last-minute fares, though some leisure fares will go up*

	DALLAS-LA		DALLAS-PHILADELPHIA		DALLAS-PHOENIX	
	BEFORE	NOW	BEFORE	NOW	BEFORE	NOW
WALK-UP FARE	\$1,078	\$647	\$921	\$553	\$651	\$445
LOWEST LEISURE FARE	\$114	\$152	\$102	\$102	\$111	\$114

Data: Harrell Associates

*One-way fares

analyst Jamie N. Baker of J.P. Morgan Securities Inc.

All of which means American's gambit is no slam-dunk. Northwest Airlines Corp. says it considered a similar move a year ago but couldn't make the numbers work. Still, there are promising signs a new pricing approach could help. Baker says Delta Air Lines Inc., which has experimented with walk-up fare cuts of up to 21% in 470 domestic markets since late August, has enjoyed an

discount price. That compares to 2.5 times six years ago. "The airlines have had their heads in the sand saying business travel is off because of the economy, period," says Kevin P. Mitchell, chairman of the Business Travel Coalition, which represents corporate travel buyers. Now, that's finally changing. Of course, in these tough times, the big airlines have little left to lose.

By Wendy Zellner in Dallas, with Michael Arndt in Chicago

COMMENTARY

By Heather Timmons

CITI: TIME FOR A SUCCESSION PLAN

Citigroup Chairman and CEO Sanford I. "Sandy" Weill is scrambling to keep his reputation intact. The 69-year-old created a respected financial behemoth by buying the right companies at low prices, ruthlessly cutting costs, and delivering outsize profits.

But investigations into Wall Street's conflicted research practices by New York State Attorney General Eliot Spitzer and others have cast Weill in a new and unfavorable light. He has had to admit he asked Salomon Smith Barney analyst Jack Grubman to "take a fresh look" at AT&T, a company that later gave Citi its investment banking business. Weill has also conceded that a \$1 million donation—from corporate funds, not Citi's charitable foundation—to New York's 92nd Street Y was related to Grubman's request for help in gaining his twins' admission to its preschool. Grubman, meanwhile, had to explain e-mail in which that he bragged he raised his rating on AT&T stock to help Weill get AT&T CEO and Citi board member C. Michael Armstrong's vote to oust Citi's then co-CEO John Reed. Grubman said his claims were "baseless" and "silly." Weill says that he never told any analyst what to write and that any notion he did so to get Armstrong's vote is "sheer nonsense."

Unless further serious allegations are revealed as the probe winds down, few think that Spitzer can make a case

against Weill or that the scandal will cost Weill his job. Still, the mess has analysts, investors, and governance experts asking if the board should put in place a clear succession plan—and announce it as Merrill Lynch &

Co. did. Weill has maintained he does not want to set up a horse race. But not having a visible plan is a luxury Citi can no longer afford. Weill's retirement is within sight if the same rules apply to him as the rest of the board. Kenneth J. Bialkin, a partner at law firm Skadden, Arps,

Slate, Meagher & Flom LLP, left Citi's board in September, when he turned 72, the age limit. Unless Weill, who turns 70 in March, gets an exception, he has just 28 months to go.

Citi has been working on a succession plan since April, 2000. But its conclusions are shrouded in mystery. The process hasn't been speeded up in light of recent events, says Charles O. Prince III, a Weill loyalist and head of Citi's corporate and investment bank. "You don't change horses in midstream," he says. Despite the opacity, Prince insists several insiders could step into Weill's shoes—including Michael T. Masin, ex-president of

Verizon Communications, who became Citi's chief operating officer in October; longtime retail banking chief Robert Willumstad, promoted to president in January; and Prince himself. Also on hand: Robert Rubin, chairman of Citi's executive committee, who was co-chairman of Goldman Sachs Group Inc.

Weill's critics argue that the Citi machine is flawed and that its CEO and manager is compromised, too. Weill still makes a mint—nearly \$13 billion



GRUBMAN

THAT'S GIVING THEM AN EARFUL, ELIOT

New York State Attorney General Eliot Spitzer stunned Wall Street recently when he used a black-tie occasion to honor the winners of the best research analysts of the year to state impolitely that virtually none of them deserved an award. Standing be-

fore the audience at *Institutional Investor* magazine's All-American Research Team Awards dinner, Spitzer said his office commissioned independent research firms to analyze recommendations made by more than 400 analysts, covering 51 industries, who had

been ranked at or near the top by *Institutional Investor*. Guess what? On their actual stock picks over the past three years, analysts who were ranked No. 1 in their fields actually had pretty mediocre performances. Spitzer went on to say that average investors wouldn't know the truth because Wall Street promoted the rankings of the analysts but withheld data on their stock-picking acumen.



quisition. In short, Weill's logic in building a supermarket looks faulty. Worse, the business model has proved a fertile source of potential conflicts. Citi collects fees from both sides when it underwrites bonds, equities, and loans—and then sells them to institutional investors and its 7 million retail clients. "Conflicts of interest seem to permeate the bank from top to bottom," says D. Quinn Mills, professor of business at Harvard University.

Weill tried to distance Citi from the scandals by revamping its practices. The structured-finance group—implicated in Enron's fall—no longer works with companies that conceal off-balance-sheet

grade of AT&T. Furthermore, they say that once a settlement is reached, they will release further internal Citi e-mail.

More mud is also headed Citi's way in the next two or three years as it battles in court with investors over its dealings with bankrupt telecom WorldCom Inc. And Citi is named in dozens of suits involving Grubman's stock picks and Enron. The litigation could prove costly if Citi loses. Analysts say that in the worst case, the price tag could be as high as \$10 billion—or about \$1.30 per share, after taxes, more than a third of 2003's estimated earnings. Citi says the number is without foundation.

TOP TO BOTTOM "Conflicts of interest seem to permeate the bank..." says a Harvard prof

WEILL, 70 IN MARCH, MAY HAVE LITTLE TIME TO RESTORE HIS CREDIBILITY

deals. Citi now expenses options. Grubman is gone, and Weill quit the AT&T board. Most recently, Citi separated its research arm from its investment bank and hired respected analyst-turned-CEO Sallie Krawcheck to run it.

But that still doesn't satisfy Spitzer. He told *BusinessWeek* that, in light of what went on between Grubman and Weill, Citi's latest move doesn't guarantee impartial research. Citi is the same company, he says. Spitzer and others are still negotiating a global settlement with banks designed to ensure that retail investors get research that isn't tainted by links to investment banking.

Regulators say they'll wrap up their investigation of Wall Street by yearend. Citi hopes the slow drip of revelations will dry up. "This is something that is about to come to an end," says Prince.

He may be whistling in the dark. Investigators say they have more evidence of conflicts—and of how poorly Citi managed them. They're still investigating Weill's role in Grubman's up-

On top of that, Citigroup faces a tough climate in its ordinary business. It still has huge exposure in Latin America. Share and bond issues—a core part of Salomon's business—are not expected to pick up through at least the first half of the year. And as one of the largest banks in lending to people with poor credit, Citi could be hard hit if consumers start to default in droves. Citi says it has boosted reserves and its performance remains strong.

For now, Citigroup still has fans on Wall Street. "Despite all the horrible things that are going on, Citigroup has been able to maintain double-digit returns on equity," says Anton V. Schutz, a fund manager at Burnham Financial Services Fund. That support extends to Weill—but it's by no means inexhaustible. "I hate to throw in the towel, but maybe it's time to say 'management is culpable,'" adds Schutz. Should that day come, Citi's board had best be ready with a plan.

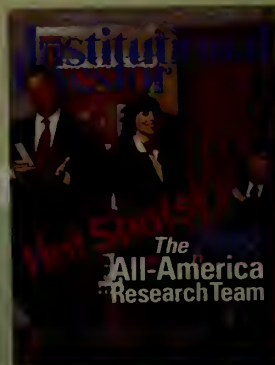
Timmons covers banking.

come in the first nine months of But controversy surrounds most of bank's major operations except those old Citibank, which Weill's Traveloup took over in 1998. Weill spun Travelers insurance business; S-Smith Barney, which he brought party, is the focus of investiga- and Associates Corp., a consumer-outfit Weill bought in 2000, has 220 million in fines for predatory violations that pre-dated the ac-

Spitzer told the audience that he was at how difficult it was for him to the data needed to measure the mance of analysts objectively. So should be surprised that Spitzer decided to force Wall Street invest-banks to make public their ana-actual performance annually t of a global agreement settling against them. "Firms will be red to disclose that data as part

of any deal," he told *Busi-nessWeek*.

In that now-infamous dinner at the Ritz-Carlton Hotel in Lower Manhat-tan, Spitzer said that "after spending hundreds of hours listening to invest-ment banks and their lawyers lecture



ANALYZE THIS: Spitzer lashed out at *Institutional Investor's* awards dinner



sary to allow it to perform efficiently." He plans to change that.

By Bruce Nussbaum in New York

MARKETING

SUDDENLY, PHILIP MORRIS ISN'T SMOKIN'

Ever-higher cigarette prices may finally be hurting profits

In the open-air Fulton Mall shopping promenade in downtown Brooklyn, N.Y., mom-and-pop florists and nail shops have long co-existed with national retailers such as Macy's and Toys "R" Us. Recently a new type of purveyor has arrived and thrived: strolling salesmen with shopping bags and a furtive pitch: "Newports. Marlboros. Five dollars."

With legit retailers charging as much as \$7.50 a pack in the most expensive markets such as New York City, where state and city taxes alone add on \$3 a pack, the nation's gray market in cigarettes is growing fast. And no one has been hit harder and faster than Philip Morris Cos., the largest and most profitable global cigarette company and maker of Marlboro,

the country's No.1 cigarette brand. Until recently, the company had continued to roll along almost undisturbed, cranking out 8% plus earnings gains despite a tough economy, rising excise taxes, grow-

ing legal expenses, and the cost of funding its share of the industry's \$10 billion-a-year settlement with state attorneys general.

No more. These days, the tobacco giant is a lot less bullish. As recently as Sept. 24, Philip Morris predicted earnings would grow by 8% to 10% in 2003. But on Nov. 12, Michael E. Szymanczyk, CEO of Philip Morris' U.S. unit, told analysts and investors that it would no longer stand by that prediction. With smoker litigation, long the No.1 worry for Philip Morris investors, suddenly tak-

A GROWING GAP

Average price of a cigarette pack

1999	2002*
MARLBOROS \$2.86	MARLBOROS \$3.80
DISCOUNT \$1.70	DISCOUNT \$2.40



* AS OF END OF SEPTEMBER

Data: Prudential Securities Inc.

ings would grow by 8% to 10% in 2003. But on Nov. 12, Michael E. Szymanczyk, CEO of Philip Morris' U.S. unit, told analysts and investors that it would no longer stand by that prediction. With smoker litigation, long the No.1 worry for Philip Morris investors, suddenly tak-



ing a backseat to earnings jitters, reaction was swift. The stock slid from \$43 a share to \$37 that day, a 14% drop, and now trades at \$38. "Litigation is always going to be a worry, but I think it will be manageable," says Morgan Stanley analyst David J. Adelman. "The fundamentals have become such a greater concern."

Such words are next to unheard of when it comes to Philip Morris. The company has 62% of the U.S. premium cigarette market and 22% of overseas sales.

WHAT'S THE MARLBORO MAN'S GAME?

The slick, 20-page antitobacco brochure appeared in mid-November in *USA Today*, *The New York Times*, and several other dailies. "Smokers are far more likely to develop serious diseases, like lung cancer, than nonsmokers," it read in part. Another barb from the antitobacco lobby? Nope. The sponsor was none other than the Philip Morris Cos., the world's biggest cigarette maker.

What's up? Company spokesperson Ellen Merlo, noting that the company had no legal obligation to print

the brochure, says that Philip Morris simply "wanted to raise awareness" for its Web site. But outsiders see a different agenda. Under legal and regulatory attack from all sides, Philip Morris is trying to show voters, jurors, and politicians that it has turned over a new leaf. It's trying

"to make it harder to penalize the industry," says Morgan Stanley tobacco analyst David J. Adelman.

These days, Big Tobacco's unpopularity is more costly than ever. Righteous juries are levying huge punitive damage awards with increasing regularity, including a \$28 billion Cali-

fornia verdict in October. Meanwhile, cash-starved state and local governments are hiking cigarette taxes.

A successful public-relations campaign could make it harder to turn Philip Morris into a punching bag. It also could give a boost to the company's push to make the Food & Drug Administration oversee cigarettes. Execs believe that if their product is federally regulated, it will be easier for them to combat plaintiffs'

lawyers and hostile local legislators.

The risk, of course, is that the campaign hurts sales. But the teenagers

who are the company's potential new customers are unlikely to plow through the densely worded pamphlet. And adults who are hooked already know about the dangers of cigarettes. So the new campaign may do little to deter folks from lighting up, making it less costly than it appears.

By Mike France in New York





cluding China. It **STOCKING UP:**
as raised its dividend *Discount*
5 times in 33 years, *cigarette sales*
and only in two years *are soaring*
as the company

failed to raise it. Addiction has also been
heck of a business model: Free cash
low, which hit \$7 billion last year, should
so rise. Philip Morris is one of the few
big companies to have barreled through
the slowdown virtually unscathed. Ana-
lysts expect Philip Morris to earn \$9.7
billion this year, a 4% gain from 2001.

So what went wrong? Start with the
2¢-per-pack price hike the company im-
posed last March in an attempt to boost
profits, a move even its fans question.
In retrospect, it looks much too large, es-
pecially since the company failed to soft-
en the blow to consumers with even a
penny of additional promotional spending,
in the form of coupons or other discounts.
Part of what's happened is of Philip
Morris' own creation," says Robert Cam-
pagnino, an analyst with Prudential Se-
curities Inc. who continues to rate the
stock a buy.

Yet part is not. Across the country,
cigarette taxes are skyrocketing. In the
past year 20 cash-strapped states have
hiked excise taxes on cigarettes, helping
to push the average price of a pack of
Marlboros to \$3.80 this fall before the
company frantically began discounting.
Together, taxes and Philip Morris' own
price hikes appear to have sparked a big
jump in discount cigarette sales this year.

With discount brands averaging just
\$2.40 a box, smokers—long thought to be
virtually price-insensitive—have finally
said enough. Discount brands such as Com-

monwealth Brands' USA Gold have had
strong sales, as have mid-tier brands like
Brown & Williamson's Pall Mall Filtereds.
Coney Elliott, who runs Kent Oil's 22
convenience stores in West Texas, says
his best-selling discount brand, Carlyle—
which goes for half the price of Marl-
boro—outsold its branded rival in Octo-
ber. That's the first time in five years
that Marlboro wasn't his top seller. "Peo-
ple are receptive to other brands," says
Elliott. "They're counting their pennies."

Smokers are also shopping at discount
shops. At the Akimel O'otham Smoke
Shop in Gila River, Ariz., manager
Robert Gaitan expects an impending ex-
cise-tax jump to have smokers lining up
to buy cheap before the hike kicks in.
At stores like his, which are located on
Indian reservation land, smokers get an
additional price break by avoiding Ari-
zona's 8% sales tax, a savings of \$2.75 on
a full-priced carton of a premium brand.

That's not Philip Morris' only prob-
lem. Many who still want name-brand
smokes are buying them from
international Web sites such as
www.yessmoke.com, where a carton of
Marlboros goes for half the U.S. price,
plus just \$2 for express shipping. The
reason they're so cheap? Some offshore
sites buy inexpensive Marlboros made
overseas for less than the U.S. wholesale
price, hurting Philip Morris' bottom line
in the process.

Moreover, while the Internet accounts
for only 2% of sales today, it's clearly a
growing threat. Forrester Research Inc.
in Cambridge, Mass., predicts online to-
bacco sales will grow from \$750 million
last year to \$5 billion in 2005. And
cheaper gray market smokes isn't the
only reason the Web threatens Philip
Morris. Discount brands also get equal
footing with the big names on most sites,
making their appeal—and their price ad-
vantage—perfectly apparent.

Szymanczyk is now moving forcefully
to contain the damage, cutting 15¢ off a
pack of Marlboros in the past month.
Even sharper discounts are planned for
the rest of the year, retailers say, and the
company has filed suit against some sites
based on copyright infringement and oth-
er issues. It is also helping the state at-
torneys general to investigate discount
cigarette makers suspected of keeping
prices low by not putting aside the mon-
ey required by the 1998 settlement be-
tween the industry and the states.

That all costs money, however, and
analysts doubt the company will be able
to cover the outlays with price increases
next year. Another dividend hike also
looks increasingly unlikely. In remark-
ably short order, old reliable has become
no sure bet.

*By Nanette Byrnes, with Mike France
in New York*

THE SKINNY ON TEEN SMOKING

Billions have been spent on an-
tismoking campaigns. Ciga-
rette taxes have been raised
in 18 states this year alone, mak-
ing lighting up a very expensive
habit. Yet the American Lung
Assn. (ALA) estimates that, every
day, 4,800 teens take their first
drag—and of those, about 2,000 go
on to become addicted to ciga-
rettes. Most disturbingly, teen
smoking rates steadily increased
throughout the 1990s, after declin-
ing in the '80s.

Given that 80% of adult smokers
develop their habit before age 18,
researchers are increasingly focus-
ing on the reasons kids start. Their
main discovery: Nicotine's proven
ability to suppress appetite and
speed up metabolism has made it a
popular diet tool for girls and
women. Studies by the University
of Michigan's Monitoring the Fu-
ture project found that 14-year-old
girls are twice as likely to try
smoking as boys, primarily because
of concerns about weight. Numer-
ous surveys have found that some
30% of teenage girls and adult
women cite weight control as the
main reason they smoke, far
greater than any other justifica-
tion. "The relationship between
concerns about weight and smok-
ing is dramatic," says Dr. Margaret
R. Rukstal-
is, a psy-
chiatrist at
the University

DIET AID: Trouble for girls

of Pennsyl-
vania, who
specializes
in addic-
tive behav-
iors.

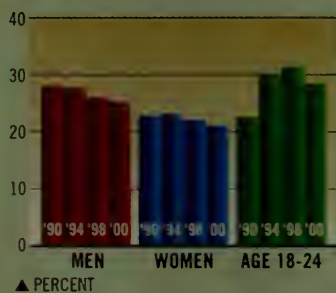
Scien-
tists are
also coming
to believe that
young brains are
biologically recep-
tive to nicotine. Based
on adult studies, it was
long thought that it takes
two years to become ad-



dicted to nicotine. But a National Institute on Drug Abuse report published in September found that some adolescents can become addicted within days of trying their first cigarette. Girls appear to get hooked faster. The research team, led by Dr. Joseph DiFranza of the University of Massachusetts, said that teenage girls reported symptoms of addiction, such as cigarette cravings and withdrawal pangs, an average of three weeks after starting. Boys took an average of six months to pick up the habit. This happened even if they only smoked two cigarettes a day.

The biggest risk factor for smoking in a kid's life is parents who light up. That makes smoking seem O.K. and cigarettes accessible. But while smoking is in part a learned behavior, some believe there is a biological predisposition. David B. Abrams, director of the Center for Behavioral & Preventive Medicine at Brown University, says that the children of smokers "may be genetically more vulnerable to nicotine addiction."

WHO'S STILL LIGHTING UP



Finally, there is the belief that kids smoke because they think it's cool. ALA President and CEO John L. Kirkwood blames the rise in teen smoking on targeted ads by tobacco companies and a romantic image of smoking in movies. Worse, the idea that smoking is cool is filtering down. Between 1991 and '96, smoking by 13-year-olds rose 50%, according to the University of Michigan survey. Today, 5.5% of eighth-graders smoke daily. It's the start of a long habit: Once teens start smoking, it takes them an average of 18 years to quit—the best reason to get them before they take that first puff.

By Catherine Arnst in New York

PHARMACEUTICALS

NEEDED: A NEW CHIEF —AND INTENSIVE CARE

Schering-Plough has a thin pipeline and onerous commitment

When drugmaker Schering-Plough Corp. announced on Nov. 13 that Chairman and CEO Richard J. Kogan would retire by April, many Wall Streeters figured that Schering's days as an independent company were numbered. Staggering from the one-two punch of repeated run-ins with the Food & Drug Administration over its weak manufacturing practices, along with the expected decline of its blockbuster allergy medicine Claritin, Schering's stock has been hammered. Moreover, as a mid-size player with little financial muscle in a rapidly consolidating industry, the drugmaker is on the wrong side of the "eat or be eaten" equation.

But Schering investors may have to wait a long time for a suitor to bail them out. The company's drug pipeline is among the thinnest in the industry, and its most promising new product, a cholesterol-lowering drug called Zetia, is tied up in a marketing partnership with Merck & Co. If Schering decides to sell to one of its giant rivals, Merck has the right to buy out Schering's stake in the Zetia venture—seriously diminishing Schering's appeal to any would-be buyer other than Merck. And the betting is that Merck, which has a well-known aversion to mergers, is unlikely to pursue a Schering buyout right now.

The upshot: Whoever is recruited to take over from Kogan will have to sort out the company's problems if Schering is to recover or become a more tempting takeover target. Among possible candidates, say analysts: former Warner-Lambert Co. CEO Lodewijk J.R. de Vink, who spent nearly 20 years in Schering-Plough's international operations, and Pharmacia Corp. Chairman and CEO Fred Hassan, whose future role

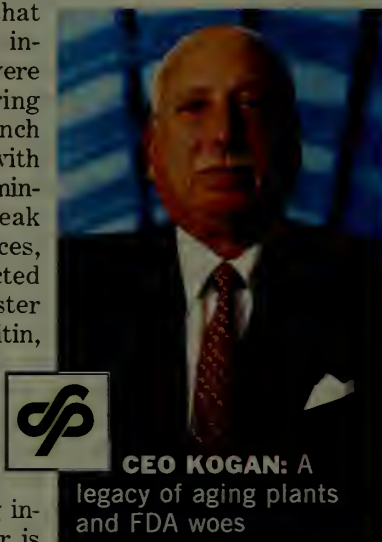
at Pfizer Inc., which is buying Pharmacia, is unclear. The winner faces a daunting task. Says an industry investment banker: "This is a crippled company."

So crippled, in fact, that it's easy to forget that Schering was an industry darling in the 1990s. Thanks to Kogan's marketing savvy, the company created a major brand in the allergy medicine Claritin. But while Kogan was busy delivering 15%-plus earning growth on the back of Claritin, he underinvested in Schering's infrastructure. The neglect particularly affected some aging plants, analysts say.

The resulting manufacturing headaches have hurt Schering's plans to protect its Novartis franchise. The company had hoped to build sales of Clarinex, a spin-off of Claritin. But the production lapses held up the FDA's Clarinex approval for a year, until December, 2001. So Clarinex hasn't yet become entrenched in the market and remains only a modest seller, while Claritin's sales are expected to plummet next year as cheap, over-the-counter versions launch. That's why SG Cowen Securities Corp. analyst Stephen M. Scala expects Schering's revenues to slide 4% in 2003, to \$10.1 billion, as net income falls 37%, to \$1.1 billion. Investors are bailing out, too. From a high of 59 in December, 2000, the stock now trades around 22.

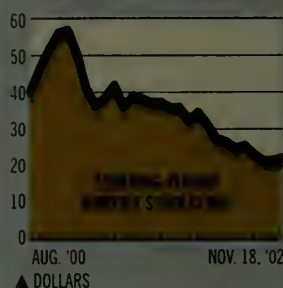
That means Schering's new CEO will be under intense pressure to move quickly. After satisfying the FDA that manufacturing is up to par, the biggest challenge will be turning Zetia into a big earner. Analysts figure that if it's a big hit, Merck may reconsider its merger aversion. That may be the best outcome Schering investors can hope for.

By Amy Barrett in Philadelphia



CEO KOGAN: A
legacy of aging plants
and FDA woes

GETTING SICKER



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Turn On the Fun

ADVERTISING

THE SHOCK WAVES ROCKING INTERPUBLIC

Scandal has scared off clients and endangered its grand strategy

Barely two months after being elevated to chairman and CEO at Interpublic Group of Cos. in January, 2001, advertising veteran John J. Dooner Jr. celebrated by making a blockbuster acquisition. His \$2.1 billion deal for True North Communications Inc., parent of mega-agency FCB Worldwide, vaulted IPG into the top rank of global ad concerns. Why bulk up at a time when the economy was softening and IPG was \$2 billion in debt following a frenzied acquisition spree? "Great clients, great people, and a shared vision for the future," Dooner declared.

Less than two years later, some of the great clients have fled, hundreds of the great people have been laid off, and an accounting scandal at the flagship McCann-Erickson WorldGroup agency threatens to put Dooner's grand ambitions on hold. With IPG's stock off 20%, to \$14, since the accounting irregularities surfaced in August, investors and insiders are asking whether Dooner is doing enough to contain the damage—and whether his grand vision of building a global-advertising supermarket can be realized. Says an exec at one IPG agency: "These people don't know how to manage their business."

Nor, for that matter, do they appear to know how to manage a crisis. Since August, Dooner has been forced to re-

state earnings three times as more accounting problems have been uncovered. The steady trickle of unwelcome news has trashed Dooner's credibility. The latest example: In mid-November, Dooner announced that earnings going back to 1997 would have to be restated to the tune of \$181.3 million, up from earlier estimates of \$68.5 million. The Securities & Exchange Commission has also launched an informal probe into the numbers. Even more worrisome, with \$44 million of the restatement stemming from other subsidiaries, the company has for the first time conceded that the accounting woes went beyond McCann. "If they didn't have formal processes to handle this issue at McCann," says David Doft, executive director of equity research at CIBC World Markets, "who's to say they have them to handle other issues?"

A chastened Dooner is scrambling to reassure investors. He has slowed the pace of acquisition-

tions and dismissed about a dozen senior executives. And he's looking for a chief operating officer to oversee global operations. That's crucial to buttressing ad rainmaker Dooner in an area where he's weak, says Greg Jackson, portfolio manager at Oakmark Global Fund, who owns 750,000 IPG shares. Clearly, it's an area where IPG needs work: The company says the accounting troubles occurred because different offices simultaneously booked the same earnings.

Beyond that, Dooner & Co. must quickly get their financial house in order. To bring costs down, more staff cuts are coming, and redundant offices likely will be closed. Investors will also be watching to see how the company deals with nearly \$578 million in debt that matures in December, 2003. While IPG hopes to reschedule the loans by mid-January, lenders could impose higher interest rates on any new loans, as well as restrictions on acquisitions, capital expenditures, and dividend payouts. Meantime, IPG's debt rating is hovering near junk.

The mishaps have also raised questions about whether Dooner's strategy to become a global-marketing superpower is working. For now, industry observers say it still makes sense because clients want a range of services on an international scale. The problem is that IPG has been unable to digest the acquisitions or squeeze out synergies. Moreover, like its rivals, IPG ventured into areas it didn't understand, including the money-losing London-based sports management agency, Octagon. If it doesn't get more adept at managing its many units soon, pressures to slim down will increase.

Dooner's job seems safe for now. IPG recently won some big new clients, including Bank of America. And investors don't entirely blame him. "Most of what he's dealing with are legacy issues," says Jackson. But if he doesn't start to rebuild his credibility—and the company's—soon, that could change, too.

By Gerry Khermouch
in New York

INTERPUBLIC'S CHALLENGES

- **RECRUIT** a chief operating officer who can restore confidence
- **TIGHTEN** fiscal controls among far-flung operations
- **FORCE** fiercely independent operating units to cooperate
- **WEATHER** an investigation by the Securities & Exchange Commission
- **RENEGOTIATE** a debt load that includes \$578 million coming due in 2003
- **SLASH** costs further by reducing staff and eliminating redundant offices

**A STEADY TRICKLE OF
BAD NEWS HAS TRASHED
DOONER'S CREDIBILITY**



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EDITED BY MONICA ROMAN

MORE INCHES PER GALLON—OR ELSE

WITH TENSION BETWEEN THE U.S. and Iraq causing jitters in the oil markets, the White House is considering raising fuel-efficiency standards for sport-utility vehicles and light trucks. Administration insiders say the latest proposal is to boost fuel efficiency by about a half-mile a gallon each year for the 2005-07 models. Right now, the average fuel economy for a fleet of vehicles sold by each auto maker must be 20.7 mpg for SUVs and light trucks.

While a final proposal won't be issued until April, 2003, the Alliance of Automobile Manufacturers says meeting the suggested requirements will be a "real challenge." Environmentalists, meanwhile, denounced the proposal as too small. According to the National Environmental Trust, the proposal would only save 2.8 million barrels of imported oil in

2005, well below the 206 million barrels of oil imported each year from Iraq.

ANOTHER PROBE FOR CHARTER

PAUL ALLEN'S CHARTER COMMUNICATIONS, already under investigation by a federal grand jury, disclosed that it's cooperating with an informal Securities & Exchange Commission probe "related to its disconnection of customers." The St. Louis-based company said it would restate \$1.2 billion in tax liabilities and \$1.4 billion in franchise costs related to 18 companies acquired in 1999 and 2000. The debt-strapped company said the restatement will not disrupt its plan to generate free cash flow by late 2003. Last month, Charter said that it had put its chief operating officer on paid leave, pending the resolution of the grand jury investigation into its accounting practices.

A SMALL TREMOR HITS HOUSING

HOUSING IS FINALLY SHOWING some cracks. On Nov. 20, the Commerce Dept. reported that housing starts fell 11.4% in October, to an annual rate of 1.6 million. But most of the decline occurred in the volatile apartment-building category. According to the National Association of Home Builders, home sales and buyer traffic picked up in November. Even with the October decline, starts are still likely to reach 1.67 million, making 2002 the best year since 1986, when home starts hit 1.81 million.

THE SEC: BEYOND SARBANES-OXLEY

OUTRAGE OVER QUESTIONABLE accounting at Enron sparked concern that its auditor,

HEADLINER: RUDOLPH GIULIANI

THANKS BUT NO THANKS, RUDY

FORMER NEW YORK MAYOR Rudolph Giuliani may want to be the new chairman of WorldCom, but the job isn't necessarily his for the taking. On Nov. 18, Giuliani said: "This is an opportunity to make a positive contribution to WorldCom."

Maybe so, but directors of the bankrupt telecom company last week appointed former Hewlett-Packard President Michael Capellas chairman and CEO, and they aren't ready to change their minds, say company executives and creditors. "Of course, Giuliani is a great guy, and we'd love to have him on

the board," says a creditor. But sources say that having Giuliani in the WorldCom chairman's job is the fondest

wish of distressed-bond investor David Matlin, who is trying to buy a third of WorldCom's \$25 billion in outstanding bonds. Such a stake would give Matlin, 41

the right to appoint WorldCom board members and to influence its reorganization plan. So far, Matlin has accumulated about 10% of WorldCom's bonds, insiders say, so he doesn't have enough clout to get Rudy the chairman's job—not yet, anyway.

Charles Haddad



CLOSING BELL

HAMMERED

Shares of Home Depot tumbled nearly 13% on Nov. 19, to \$24.91, after the retailer said that third-quarter sales at stores open at least a year slipped 2%. Customers are being scared off by disruptive renovations that Home Depot is doing to compete with Lowe's. Analysts also fret that the home-renovation boom is coming to an end.



Arthur Andersen, may have turned a blind eye to accounting irregularities in order to win consulting business. Now, the SEC aims to thwart such conflicts of interest. On Nov. 19, the commission proposed new auditor-independence rules as required by the Sarbanes-Oxley corporate reform law enacted in July. But the suggested SEC rules go beyond what the law mandates. They would bar an accounting firm from paying audit partners for consulting work that the firm does for companies the partners audit.

CLEANING UP AFTER CHARLES WANG

WHEN CHARLES WANG, ONE of the software industry's legends, finally called it quits on Nov. 18, he left his hand-picked successor, Sanjay Kumar, with a mess on his hands. Computer Associates International, the company

Wang co-founded in 1976, being investigated by the federal government for accounting issues. Kumar has been CEO for two years and now picks up the chairman's title. In September, he handed the government an audit by PricewaterhouseCoopers that he says vindicates C. Unless Kumar makes the investigation go away, his stock won't go anywhere. It's trading at about \$15—way below the \$30 it fetched before the feds barged in last February.

ET CETERA...

■ Diageo failed to sell Burge King for \$2.26 billion to a consortium that included Texa Pacific Group.

■ Hewlett-Packard earned \$390 million on \$18 billion in sales in its fiscal fourth quarter.

■ United Airlines won wage concessions from its machinists, clearing the way for government loan guarantees.



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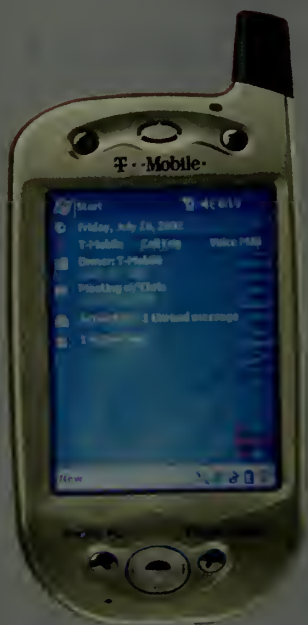


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RICHARD S. DUNHAM

ARE DEMOCRATS LOSING THEIR GRIP ON THE UNION HALL?

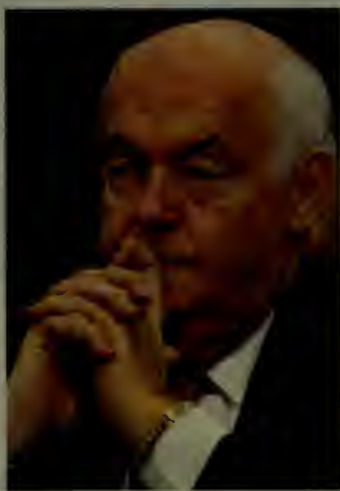
The AFL-CIO's President, John J. Sweeney, had the business community sweating when he promised an unprecedented get-out-the-vote effort in 2002. But when the ballots were counted, there was good news and bad news for labor. Union workers turned out in near-record numbers—but never voted Democratic than in recent years.

Election Day surveys by Democratic pollster Stanley B. Greenberg show that his party's share of union members' congressional votes shrank to 58%, down from 64% in 2000.

Most troublesome for Democrats is declining support in some polls among industrial unions, white workers, and younger members. Democratic-leaning unionists are facing resistance even from their families: Greenberg's poll showed that relatives of white union members favored Republicans, 47% to 46%.

AFL-CIO officials dispute Greenberg's findings but acknowledge their own polling shows a two-point drop in support for House Democrats from 70% in 2000 to 68%. The shift toward the GOP, while modest, is enough to give some Democrats flashbacks to the days of the old Reagan Democrats. With White House political guru Karl Rove aggressively courting culturally conservative, highly patriotic, blue-collar union members, Democrats fear that the drip, drip, drip of 2002 could become a gusher in 2004. "There's a cultural problem in the Democratic Party, and that is we exude weakness," says party strategist James Carville.

A tough stand against terrorism is a start. But Democrats will continue to face fierce competition for union votes if they can't articulate a coherent economic revival agenda. In 2002, argues Robert L. Borosage of the Campaign for America's Future, a liberal think tank, "Democrats had literally nothing to say, except that the economy was in the pits, which most everyone already knew."



SWEENEY: Defections

Without a compelling economic rationale for backing congressional Democrats, many union members decided to support a President they view quite favorably because of his toughness and plain-guy demeanor. "It was a very personal victory for George Bush," says G. Terry Madonna, a political scientist at Millersville University of Pennsylvania.

It was also a victory with very real consequences for organized labor. Just nine days after the election, the White House Office of Management & Budget announced it was going to open up 850,000 federal jobs to private-sector competition. And on Nov. 19, all but eight Democratic senators voted with Bush to end union protections for 170,000 government workers in the new Homeland Security Dept.

An anti-labor binge by the Republican Right could create a backlash in union halls. But Democrats can't depend on GOP overreaching. A better strategy might be modeled on the success some Democratic candidates for state office had talking about kitchen-table issues. In Michigan, Democratic gubernatorial victor Jennifer M. Granholm pushed an aggressive economic-recovery plan—and carried the union vote by 72% to 27%, according to pollsters EPIC/MRA. Likewise, Pennsylvania's Edward G. Rendell garnered two-thirds of the rank and file's support, the Keystone Poll found.

Still, the Democrats are facing a continuing battle for the support of industrial unionists. At the same time that Rendell was winning big, three Republican congressional candidates were sweeping the union vote in western Pennsylvania's mining and mill towns.

Unless the Democrats can find a way to bring these workers home, they are likely to split their tickets for years. And that would be a huge victory for Rove, who is seeking to transform union members into swing voters rather than the straight-ticket Democrats their leaders want them to be.

CAPITAL WRAPUP

WILL WHITMAN GO FIRST?

► With the elections over, Washington lobbyists have begun playing the traditional game of guess-which-Administration-official-heads-for-the-exit-first. Leading the speculation: Environmental Protection Agency Administrator Christine Todd Whitman, the former New Jersey governor who has fought the White House on clean air and arsenic standards in drinking water.

Associates say Whitman would prefer an ambassadorship. This spring, she jokingly told a Washington black-

tie dinner that, in 2000, she was excited to hear she was on the short list for Vice-President, only to learn that she was on another list. "It turned out to be the short list of Republicans who care about the environment," Whitman cracked. A spokeswoman dismisses the rumors, but EPA insiders expect Whitman to resign by yearend.

If Whitman goes, business would want someone more sympathetic, like Josephine S. Cooper, president of the Alliance of Automobile Manufacturers. But that would set off a firestorm of opposition from enviros, already bracing

for a big shift at the Senate Environment Committee, where James M. Inhofe (R-Okla.) will replace the very green James M. Jeffords (I-Vt.). One possibility is outgoing Michigan Governor John Engler, who has been pro-auto without alienating most moderates. More likely: David B. Struhs, who has built bridges between greens and business as Florida Governor Jeb Bush's environmental protection secretary. Struhs has another advantage: He's the brother-in-law of White House Chief of Staff Andrew H. Card Jr.

By Laura Cohn



ELECTRONICS ASSEMBLY: *Inexpensive exports have kept Westerners spending and have been a c*

CHINA

HOW LOW CAN PRICES GO?

China's cheap exports worry the West

Four years ago, China figured prominently in the disaster scenarios of some international economists. At the time, South Korea, Thailand, Indonesia, and Russia had all suffered severe currency crashes—and contagion was raging through South America. As a result, China's once-booming export machine sputtered to a near-halt, and its manufacturers were pleading with the government to do something. What would happen if China were to sharply devalue its currency to boost its competitiveness? The result, economists wor-

ried, would be another devastating round of devaluations around the world that would exacerbate the global financial crisis. Beijing thought long and hard. In the end, it decided to keep the yuan fixed at 8.28 to the U.S. dollar, to the great relief of the outside world.

These days, Beijing again is coming under pressure to do something about the yuan—still valued at 8.28. But now it faces an entirely different conundrum. Trading partners such as Japan and the U.S. are urging China to let its currency appreciate. Why? Because Chi-

nese factories are flooding the world with cheap goods, everything from televisions and DVD players to bicycles and children's pajamas. At a time when most of the global economy is on its knees, Chinese exports have rocketed by 20% so far this year, while its economy is expanding by nearly 8%. In China itself, overproduction has helped push industrial prices down by 7% over the past five years and retail prices by 10%.

To most U.S. consumers, of course, this is a blessing. Made-in-China products have helped keep inflation at bay in the U.S. And China's rise as a manufacturing power has cemented its relationship with the rest of the world.

But a growing minority of economists and policymakers are arguing that a deflationary China poses a real threat to the world. "China's prices are becoming global prices," Morgan Stanley economist Stephen S. Roach wrote in a recent report. Already pricing power over the past decade has collapsed for many consumer-electronics firms, apparel makers, and others. And even though few American producers compete with Chinese goods, Chinese manufacturers are rapidly moving up the food chain into semiconductors, telecom equipment, and other sophisticated digital devices. If the Chinese start dominating these in-

Japan, the U.S., and others want Beijing to let its currency

DEFLATIONARY CHINA AS CHINA'S EXPORTS SURGE...



...ITS PRICES DECLINE



Data: Salomon Smith Barney, Global Insight, BW



KODAK IN SHANGHAI: Overcapacity may be a problem

flation

ustries, some fear robust pricing will never return to these sectors.

Chinese prices are already causing imbalances in the developing world. Mexico is seeing the flight of whole industries to the mainland. New manufacturing investment has plunged in most of Southeast Asia. The Japanese are already exploring exporting autos from China. Meanwhile, an influx of cheap Chinese consumer items and foods is raising hackles from Japanese producers. Haruhiko Kuroda, Japan's vice-finance minister for international affairs, warned in mid-November that "China will be exporting price deflation to the other Asian countries" as it produces more sophisticated products.

Kuroda's solution: Revalue the yuan by an unspecified amount. Chinese Finance Minister Xiang Huaicheng says Washington is starting to push similar advice. The idea is to make China's products more expensive, which in turn would curb exports.

If only it were that simple. China's competitiveness is so strong that it could easily compensate for a moderate rise in the currency. The supply of \$100-a-month Chinese labor is virtually inexhaustible. And \$50 billion in annual foreign investment is pouring into China, much of it going to build state-of-

the-art factories for U.S., Japanese, and European multinationals. That money is upgrading Chinese industry and boosting productivity by 4% annually, according to the Bank of China.

Another point: A stronger yuan would just make it cheaper for the Chinese to import materials and machinery—which they would turn into products for export. The Chinese would simply pass on the savings from cheaper import costs in their products.

It would take a surge in China's currency on the order of 25% to make much of a difference. But that could spark a financial crisis in China: A drop in exports would wipe out the weakest producers and hammer the banking sector, which is already shouldering some \$700 billion in bad loans. A social crisis could well follow, as millions join the swelling ranks of China's unemployed.

It's not even clear if floating China's currency would result in a stronger yuan. Some analysts say that, based on China's huge bad loan problem, the currency should be weaker than it is.

Even Americans are aware of this risk of revaluing. During a recent visit to China, former U.S. Federal Reserve Chairman Paul A. Volcker warned that revaluing the yuan would invite a frenzy of speculation that could be "destructive

to economic development." China, he added, "ought to stick with its policy of maintaining stability with the U.S. dollar."

What's more, some argue that other factors are amplifying the China effect. Even though 16% of Japan's imports come from China now, vs. 6% a decade ago, that is still only equal to 1.6% of Japan's gross domestic product, estimates Goldman, Sachs & Co. Managing Director Fred Hu. That's keeping retail prices tame. But the real cause of deflation in Japan is Tokyo's flawed monetary policy. Its financial mandarins have not been able to stimulate business investment or consumer spending. In fact, China may be helping here. Marcus Noland of the Institute for International Economics notes that in those sectors of Japan's consumer economy where Chinese imports are lowering prices, consumption is actually rising. "This is increasing real incomes in Japan," notes Noland. In the U.S., meanwhile, falling import prices "are beneficial for us in a macro sense," he adds.

China's export juggernaut will certainly mean plenty of disruption for the global economy. But don't look for quick solutions. China deflation won't go away until the flood of workers from farms to factories slows—a process that will take decades.

By Mark L. Clifford in Hong Kong

preciate. But China as a deflationary force is here to stay



KIEV PROTEST: Polls show 70% of citizens distrust Kuchma

UKRAINE

DASHED HOPES IN UKRAINE?

Scandal threatens its budding but fragile economy

When it was privatized in 2000, the Odessa Oil & Fat Plant was a rusted hulk in the grimy Moldavanko section of this Ukrainian city on the Black Sea. But Konstantin Grigorishyn, 36, a former physicist who built a fortune trading computers and currency in the 1990s, thought it had potential. He spent \$12 million on top-of-the-line equipment, and sales

BAD MOVE?
Kuchma may have O.K.'d sales to Iraq

have climbed from \$20 million to \$80 million since privatization. Thanks to investments such as Grigoryshin's, Ukraine's \$38 billion economy is on track to grow by 4% this year.

So is it finally time to cheer for this former Soviet Republic as entrepreneurs rebuild an economy devastated by a decade of industrial banditry? No—it may be time to weep. A government scandal is threatening the country's budding but still-fragile economy and may thwart its long-range goals of membership in the European Union and NATO.

At the center of the tempest is President Leonid Kuchma, a 64-year-old former Soviet factory director. According to audiotapes secretly made by Kuchma's former bodyguard and recently authenticated by the Bush Administration, Kuchma, back in 2000, approved the sale of a Ukrainian-made Kolchuga aircraft-detection system to Iraq. The sophisticated device is capable of helping Saddam Hussein shoot down U.S. and British warplanes patrolling Iraq's airspace. It's not clear whether the system was actually delivered, but such a transaction would violate U.N. sanctions against Iraq. The Bush Administration, which has suspended \$55 million in U.S. aid while it ponders further action, is not accepting Kuchma's denial that he approved the sale. "To be a part of the West, Ukraine has to act like the West," says a U.S. diplomat.

The Iraq scandal is merely the latest em-

barrassment for Kuchma. The ex-bodyguard's audiotapes also implicate him in the gruesome beheading last year of Ukrainian investigative journalist, Giorgi Gongadze, and a Kiev appellate court recently opened a corruption probe against him. Kuchma has denied involvement in the murder.

Fighting to save his presidency and spur stalled reforms, Kuchma on Nov. 6 sacked Prime Minister Anatoly Kinakh. On hold in Parliament are such measures as a cut in the top rate of personal income taxes from 40% to 20%. That's especially painful because recent gains in economic growth are just beginning to trickle down to workers, who earn an average monthly wage of \$80.

Polls show some 70% of citizens distrust Kuchma. Some are taking to the streets to demand his resignation—two years before presidential elections. At the Nov. 7 demonstration in Kiev, 5,000 protesters chanted "Kuchma, het!" ("Kuchma, out!"). "Unemployment is flourishing, salaries are not paid on time, a prostitution is spreading," said Mykola 51, a worker who declined to give his last name for fear of being identified. "We don't need this regime."

There is a viable alternative: former Prime Minister Viktor Yushchenko, the most popular opposition figure. He has good ties with Western leaders, who like his emphasis on economic reforms. But the U.S. comes down too hard on Kuchma, it risks being portrayed as a bully. That's why the best outcome would be the emergence of a nonviolent protest movement that forces Kuchma to step down in favor of early elections—something akin to the way Serbian President Slobodan Milosevic was removed from power. Yet much as Kuchma is despised by most Ukrainians, following a tradition of passivity, haven't joined in the protests. "If the political regime changed, it will happen because of the

Americans, not because of the people," says Jacques Mounie, head of Crédit Lyonnais' Kiev branch. Still, the question, it seems, is what the Bush Administration wants to do about another nation in its ever more-crowded gallery of rogues.

By Paul Starobin in Odessa, with Roman Olearchyk in Kiev

ECONOMIC PROGRESS AT RISK



A black and white photograph of a person sitting at a desk, looking at a computer monitor. In the foreground, there is a snow globe containing a small snowman. The scene is dimly lit, suggesting an office environment.

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COMMENTARY

By Jack Ewing

SCHRODER IS WAFFLING WHILE GERMANY BURNS

They were dentists, and they were mad. Joined by rows of equally angry doctors, nurses, and pharmacists, they waved placards and blew noisemakers beneath the Brandenburg Gate, within earshot of Parliament. Their gripe: proposed cuts in health-care coverage.

When dentists take to the streets of Berlin, that's a good sign that things are getting out of control. And it's not just the dentists and other health-care workers. Every interest group in Germany is determined to make sure that somebody else bears the pain of the nation's worsening budget crisis. Chancellor Gerhard Schröder seems helpless to deal with the outcry. As proposals are floated and then quickly withdrawn, the result appears to be chaos. "It's a disaster," says Roland Flach, chief executive of WCM Beteiligungen und Grundbesitz, a Frankfurt company that buys and restructures ailing German corporations.

As economic growth grinds to a near-halt and tax receipts decline, the logical solution would be to cut government spending and reduce taxes to boost consumer spending. But Schröder seems incapable of following such a course. Instead, he and Finance Minister Hans Eichel have proposed tax increases.

GRASPING AT STRAWS

Rather than cut spending, Schröder wants higher taxes. The hikes he's proposing are aimed mostly at business

partner at consulting firm Cap Gemini Ernst & Young Deutschland and a former economics minister.

A sensible plan to tackle the country's \$70 billion budget hole would have Schröder attacking Germany's massive subsidy system. The nation shells out an astonishing 7.5% of gross domestic product in subsidies and tax breaks each year, much of it to prop up dying industries, according to the nonpartisan Kiel Institute for World Economics. Despite much talk of "social justice," most of the money benefits corporations and the middle class. Germany could easily eliminate

its deficit by slashing this welfare.

That's not going to happen. The German public is only beginning to accept the idea that subsidies sap money from more productive uses, that keeping a dying industry alive only prolongs the pain. The Maxhütte steel plant in the city of Sulzbach-Rosenberg in Bavaria survived on subsidies for some 25 years before it shut down recently. If the factory had been allowed to die in the late 1970s, the region would have had a chance to recover by now.

Schröder can be feisty and inspiring but has been neither recently. In-

WHERE GERMANY COULD CUT

PENSIONS Longtime government employees receive up to 80% of their final salary, costing the government \$25 billion annually.

SUBSIDIES Subsidies and tax breaks totaled \$156 billion in 2001, much of it questionable. One example: \$2.3 billion a year for sports-club managers.

BETTER COST CONTROL Officials don't have a handle on spending. Example: The defense ministry spent \$157 million developing an antitank rocket the army didn't want.

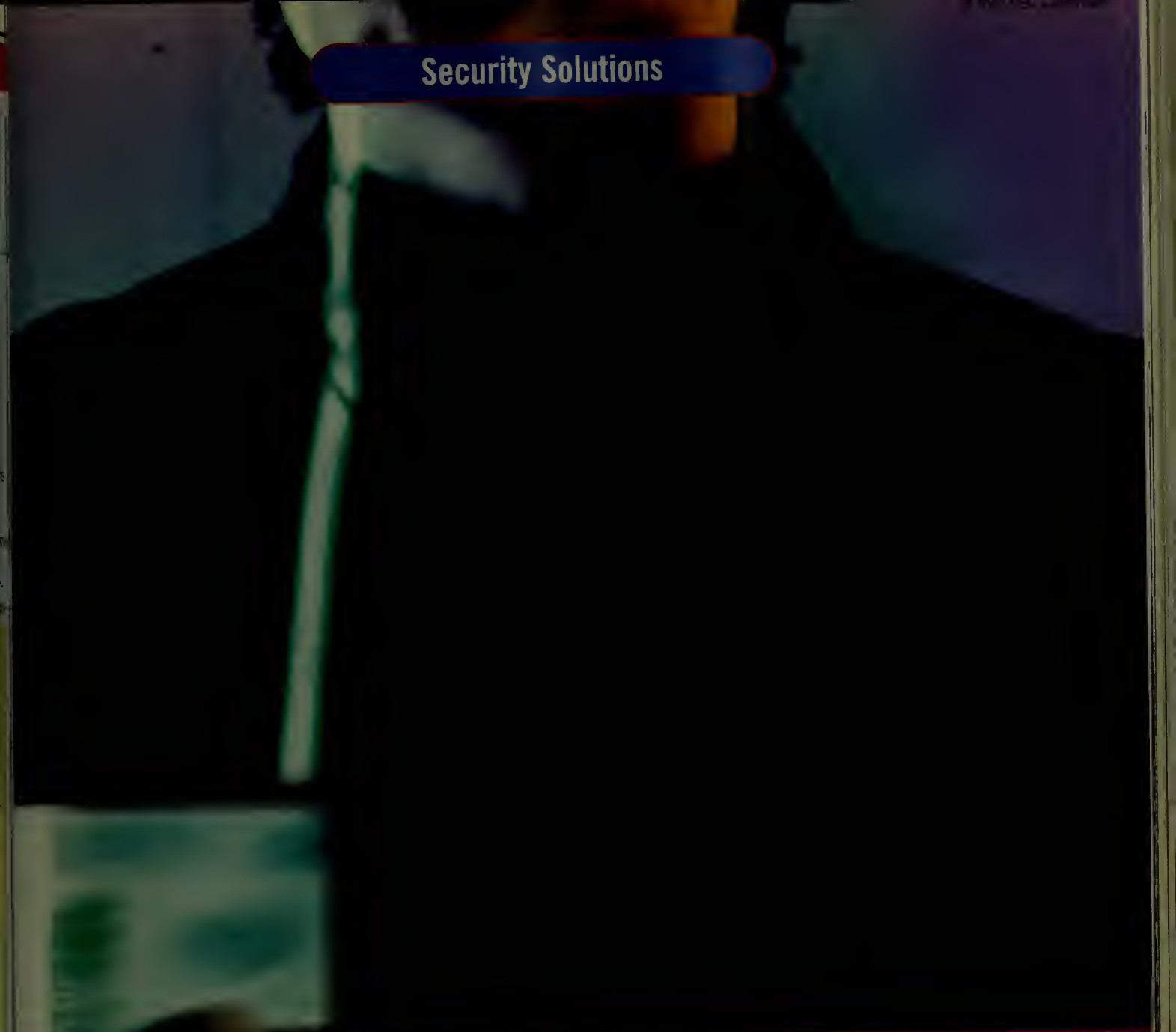
Data: Association of Taxpayers, Kiel Institute for World Economics, Federal Auditing Office



stead, he's been pummeled in the press and has seen his public approval plunge. He has a history of appearing lost amid a crisis, though, only to find an inner reserve of leadership at the last moment, as he did in the recent election campaign.

Can Schröder once again summon his decisive side? Deep down, he's a fighter. The son of a widowed cleaning lady, he's a man who had to work at construction jobs to get through law school, yet climbed to the top of German politics. Now, though, he's acting like a guy who's scared of a bunch of dentists.

Ewing covers German politics and business from Frankfurt.



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EDITED BY ROSE BRADY

BRITAIN: THE UNIONS ARE MAKING BLAIR'S LIFE MISERABLE

For the first five years of Tony Blair's government, British unions were so thrilled about the Labour Party's return to power after 18 years in opposition that they kept their demands in check. But two years into Blair's second term, the honeymoon is over. From Nov. 13 to 15, firefighters staged a 48-hour nationwide strike—the first since 1977. A new generation of more militant union leaders seems bent on making life miserable for Blair and the British public.

This new restiveness could prove Blair's biggest challenge at home. While he is known to the outside world for foreign policy splashes, such as backing the U.S. on Iraq, Blair risks losing credibility at home. He won a general election victory in 2001 by vowing to improve Britain's public services, and he has earmarked \$6.3 billion for everything from public transportation to education next year. The country's ailing health service is to get \$63 billion in new funding over the next five years. But the unions are now out to suck much of the loot in pay increases. Blair is in no danger of losing his job. He enjoys a huge majority in Parliament, and his Conservative opponents have been consumed with fighting for years. But a series of debilitating strikes could hamstring Blair and ruin his chances of reconstructing state services. Worse, the unions' demands could undermine Britain's hard-won economic stability. Much depends on how the Prime Minister handles the new wave of strikes. The government is trying to persuade the firefighters to accept a 16% increase phased in over three years and linked to improved efficiencies. That would be a big improvement over the Fire Brigades Union's initial demand of a wage increase of 40%—nearly 20 times the current level of inflation—to \$48,000 a year. While the firefighters might

agree to a 16% pay deal, they are resisting the government's call to link any increase to modernizing practices. "Why fix what isn't broken?" declares Paul Scotting, a retired London firefighter.

But even if this standoff is resolved before the firefighters walk out again in an eight-day action threatened to begin on Nov. 22, more trouble seems sure to come. Postal workers and airport employees, as well as ambulance, train, and tube drivers, are gearing up for battle. In some cases, union members are threatening to strike before Christmas. "There are a lot of demoralized teachers, doctors, nurses, and social workers out there," says Mike Terry, a professor of industrial relations at Warwick Business School. Their demands have been fueled by an August pay deal worth up to 10.9% over two years for 1.3 million local government workers—nearly double the current average income growth for British public sector workers.



ON STRIKE: Public-sector workers are angry

Meanwhile, the government is wary of the precedent that such inflationary deals could set. Every percentage-point increase in the pay of the country's 5 million public sector workers costs the government a hefty \$1.6 billion. Chancellor of the

Exchequer Gordon Brown recently told Parliament that giving in to excessive pay demands would come at the cost of jobs and badly needed investment in public services. But such finger-wagging doesn't impress hardliners such as Bob Crow, the vocal leader of Britain's Rail, Maritime, & Transport Union. His members have spent the past few years struggling to keep up with inflation while reading about seven-digit bonuses for investment bankers. That's why Blair now faces a dangerous game.

By Kerry Capell in London

GLOBAL WRAPUP

PAKISTAN'S NEW GOVERNMENT

► After 42 days of bickering among political parties elected on Oct. 10 to Pakistan's National Assembly, a new Cabinet looks set to take office in Islamabad. This will mark Pakistan's first civilian government since General Pervez Musharraf took power in a bloodless coup in 1999. A Musharraf ally, Mir Zafarullah Khan Jamali, 60, is expected to be elected Prime Minister by the National Assembly. The former chief minister of the province of Balochistan is a leading member of the pro-

Musharraf Pakistan Muslim League (Quaid-E-Azam) and is likely to support the President's initiatives, including backing the U.S. war against terrorism and economic reforms at home.

That's a relief for Musharraf and for the Bush Administration, which was initially concerned about the success of Islamist parties in the election. A religious alliance known as Muteheda Majlis-e-Amal gained a substantial parliamentary minority as well as control of the provincial government in the North-West Frontier Province, which neighbors Afghanistan. The alliance

has threatened to thwart U.S. efforts to capture al Qaeda terrorist suspects, but Musharraf and the new government can be expected to overrule them. Cooperation with the U.S. is crucial to ensure continued foreign aid flows to Pakistan's still-fragile economy.

Still, it won't be smooth sailing for the new coalition government, which will be ruling with a thin majority in the Assembly. Loud debates about Musharraf's near-dictatorial powers are likely as Pakistan continues to experiment with its brand of democracy.

By Naveen A. Mangi in Karachi

Like many other Web businesses, it was a good idea that took time to blossom. The year was 1997, and Masterfoods USA, the division of Mars Inc. that makes M&M's, launched an online site called Colorworks. It offered a palette of 21 colors to coat specially ordered M&M's. Customers could pick any combo—maroon and gold, say, for their school colors, or silver for that special anniversary. It was a model of flexibility except for one thing: The minimum order, designed for wholesale buyers, was 40 pounds—enough M&M's to give the celebrating couple a sugar overdose.

Chocolate lovers clamored for smaller portions. And in April, 2001, Masterfoods responded, tweaking its manufacturing to produce eight-ounce and five-pound customized bags and selling them online. Although these cost nearly three times the price of regular M&M's, they've become a growing niche business, with sales doubling every year, say execs. "We're using technology to give consumers the products they're after," says Bill Simmons, general manager of the Masterfoods business development team.

From colored bits of candy to hockey sticks and complex plastics, lots of items are now being tailored to individual desires. This is part of a continuing industrial evolution—from mass production to mass customization. The result is the mass market of one. And the Web is helping to bring it about. Companies are wooing shoppers with a digital version

of the classic Burger King come-on: "Have it your way."

The appeal is extending from retail stores

Special Report

W E B S M A R T

into the labs of the world's biggest manufacturers. Procter & Gamble Co. lets shoppers design everything from eye moisturizer to liquid foundation makeup at its reflect.com site. Engineers at Rockwell Collins Inc. use virtual online labs to tailor materials for fighter-pilot visors. And Yankee Candle Co. woos buyers with brightly-hued labels and exotic scents they can mix and match for the right candle. "Mass customization will grow, becoming a necessity in some industries," says Paul H. Zipkin, professor at Duke University's Fuqua School of Business.

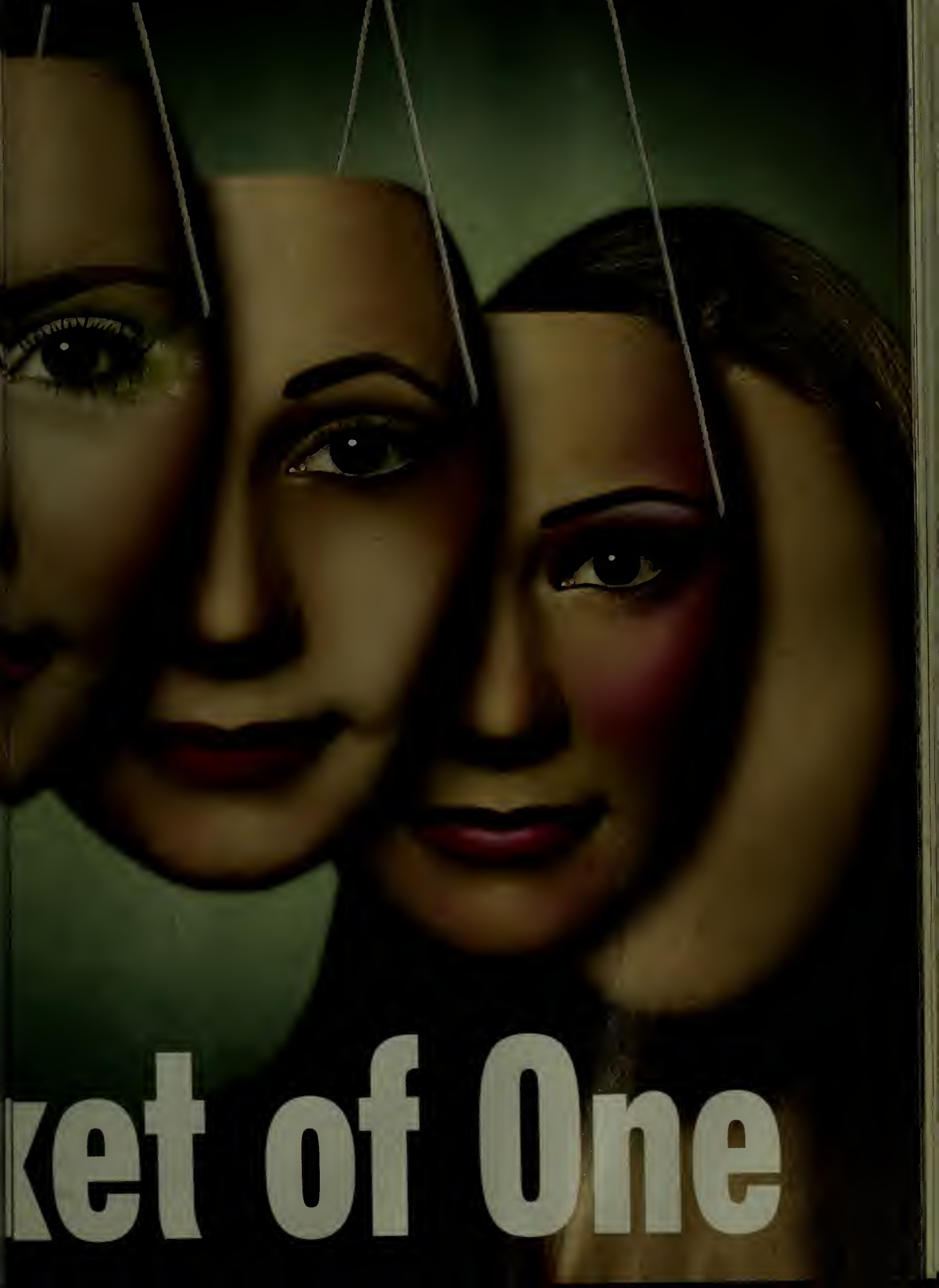
Companies are approaching this new world with caution, and with good reason: The Web can find plenty of customers for made-to-order

MELISSA SZALKOWSKI

As **CUSTOM ONLINE ORDERING** moves into the mainstream, Web merchants learn to fine-tune their trade

A Mass

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products, but retooling a factory to spit out thousands of faultless variations on a theme is no easy job. Nike Inc., for example, spent six months working with suppliers in Asia to

Special Report

WEB SMART

start off with reduced offerings. Staples Inc. lets customers pick fabrics or colors—but only for chairs.

Today's custom e-marketers have lots to learn from services that have flopped. One clear lesson: It's nearly impossible to customize tastes. Why? Words rarely suffice. When General Mills Inc. launched Mycereal.com two years ago, it urged breakfasters to order their dream cereals. But customers found that the taste fell far short of their mouth-watering descriptions—and cost more than \$7 a box to boot. It was the same story at P&G's coffee site, Personalblends.com, which tempted coffee lovers with blends customized to their own tastes. Shoppers were stumped by the questions designed to help define their taste—and were unwilling to pay the \$10 a bag that P&G needed to charge.

Lands' End Women's custom-made chinos and jeans, launched a year ago online, are a big hit with Hobbs (right). They cost 54% more than regular orders, yet they account for 40% of its chinos and jeans sold online. What's new: Men's dress shirts and twill pants.

Still, recipes for success are emerging. Industries such as clothing that can charge a premium for quality are a natural. Others, like golf clubs and hockey sticks, that deal with simple shapes also have an edge. For businesses rooted in databases, from credit-card companies to mortgage lenders, the race to the mass market of one is well under way.

Customization not only expands markets but also allows businesses to charge more. Take Branches Hockey in Osceola, Wis. In April, 2001, the stickmaker launched a service that lets consumers order customized products. Players pick from 26 options, including the length of a stick, blade patterns, and curve patterns for the blade. Branches plugs the data into its digital cutting equipment and cranks out a custom stick in five days. The company charges 39% more for custom sticks. Branch-

es says the online offering has increased revenues for the tire business by as much as 25% in the past year.

Companies that turn to customization can offer service that wouldn't work without the Web. Catalog clothing company Lands' End Inc., which only has a handful of out-

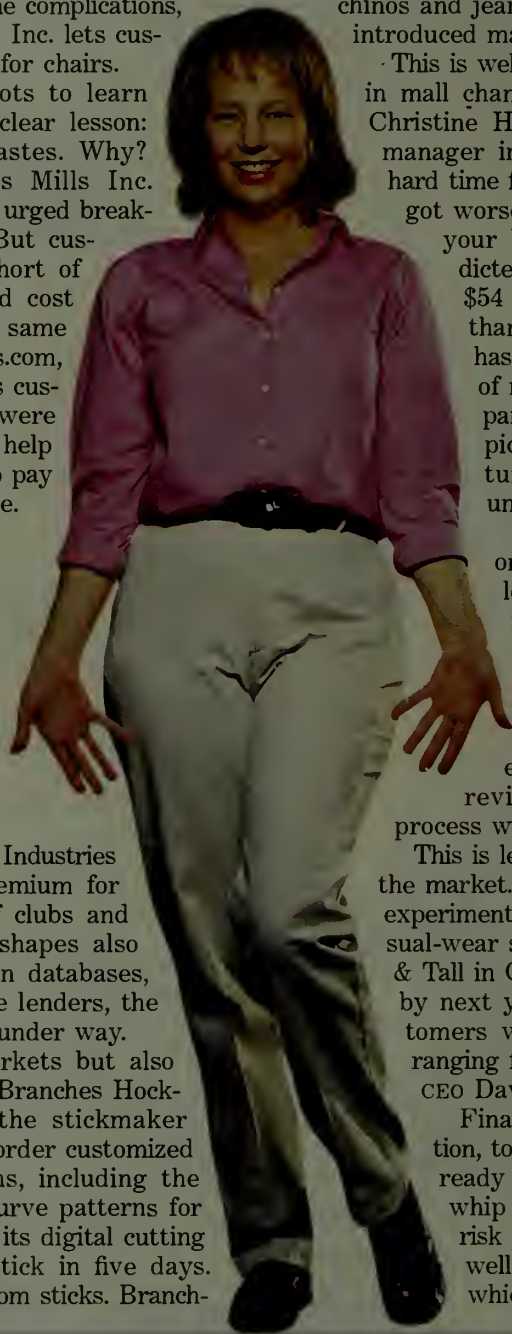
stores, introduced customized chinos online a year ago: jeans early this year. Now, custom orders make up 40% of chinos and jeans sold online. In November, Lands' End introduced made-to-order twill pants and dress shirts.

This is welcome news for shoppers who spend hours in mall changing rooms, hunting for the elusive Christine Hobbs, a 33-year-old database marketing manager in Costa Mesa, Calif., has always had hard time finding pants to fit her 5-ft.-11-in. frame. She got worse after she turned 30. "As you get older, your body turns into shapes you never predicted," says Hobbs. So she was happy to pay \$54 for a pair of brown chinos—\$19 more than the off-the-rack equivalent. Lands' End has to charge more to cover the higher cost of making customized clothing. But the company is hoping that as the custom operation picks up steam, higher-capacity manufacturing processes will lower the cost per unit, boosting profit on the premium line.

For shoppers, buying tailor-made clothing online requires a little work and an honest look in the mirror. Hobbs typed in her measurements and had to answer a series of questions about the shape of her body. Yet all this effort works to the advantage of the e-merchant. Once shoppers have laboriously created profiles at an e-merchant, they are far more likely to revisit the same site than to repeat the process with a competitor.

This is leading more apparel retailers to hurry into the market. Bob's Stores, based in Meriden, Conn., experimenting with Web kiosks in a couple of its casual-wear stores in the Northeast. Casual Male Big & Tall in Canton, Mass., also plans an online system by next year. "We think we can attract new customers who can't fit into our traditional sizes ranging from a 44-inch waist up to 80 inches," says CEO David Levin.

Financial services are naturals for customization, too. Credit-card and mortgage companies already have ready traffic in digital information, so they can whip up loans to fit a wide range of specific risk profiles—and charge personalized prices as well. Handling costs at IndyMac Bancorp Inc., which processes 75% of its \$20 billion in an-



The Right Stuff *Mass customization isn't for every company, but here are some fields where it can work:*

HIGHER-PRICED PRODUCTS

Shoppers must be willing to pay more to offset custom costs. Lands' End tailor-made chinos sell for \$54, vs. \$35 for a standard pair. Customized shampoo at reflect.com costs six times more than drugstore brands.

NO-FRILLS MANUFACTURING

Products with simple shapes do well. Robotic factory tools stamp out custom golf clubs, bicycle frames, or hockey sticks. Branches Hockey sells nearly a third of its sticks custom-made online.

MIXING AND MATCHING

Complex processes that choose from huge databases are a natural. GE Plastics has a site where customers can pick among 1,000 kinds of plastics and use simulation to see how the product performs.

KEEPING UP TO DATE

State-of-the-art production is key. Profits hinge on glitch-free manufacturing that adjusts fast to orders. Nike spent six months overhauling factories in Asia to revamp production and install new software.



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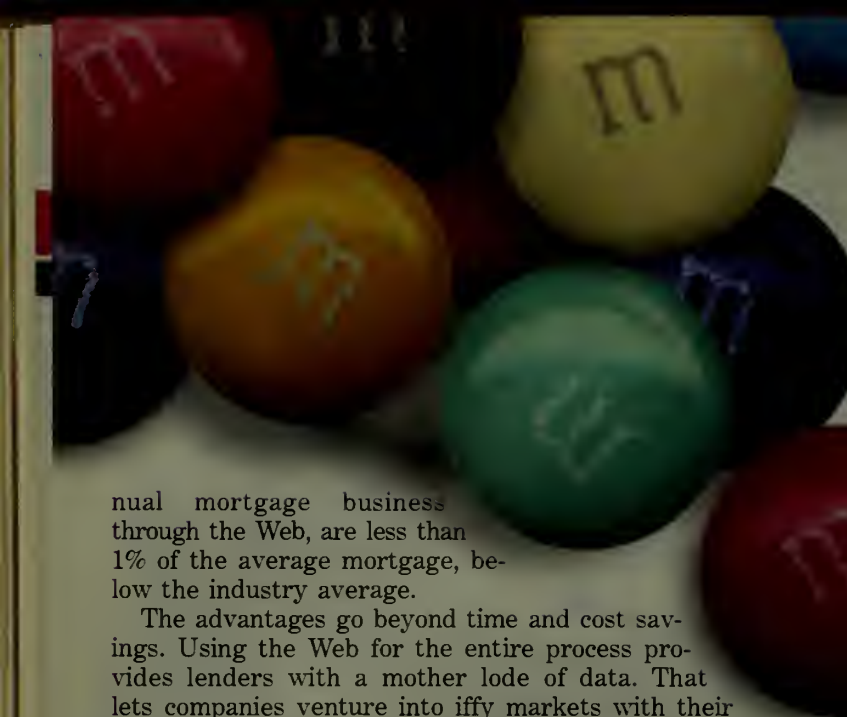
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nual mortgage business through the Web, are less than 1% of the average mortgage, below the industry average.

The advantages go beyond time and cost savings. Using the Web for the entire process provides lenders with a mother lode of data. That lets companies venture into iffy markets with their eyes wide open. Top credit-card issuer Capital One Financial Corp. took the plunge into subprime lending in late 2001 and saw its delinquencies rise. Reading the data provided by customers who gave detailed info online to get credit cards, Capital One grasped the source of the problem and could customize higher rates and fees for riskier clients. "There's a risk-based price for almost any loan," says Richard

H. Wohl, president of IndyMac's mortgage-banking group.

While digital products zip through the

Web, physical goods can't. But industrial companies that build products based on formulas that can be digitized are off and running. General Electric Plastics in Pittsfield, Mass., is using that advantage to reach more clients and cut costs. In 2000, the company started putting design tools on its Web site that would allow client companies to configure plastics for thousands of products. Now, about 210,000 employees at 70,000 companies use the service.

David Krevor, principal engineer at aviation electronics manufacturer Rockwell Collins, turned to the GE Plastics Web site to help him with the most demanding contract he had ever faced. Last year, Rockwell redesigned a visor for the helmet of fighter pilots. The military wanted the visor to contain the targeting system that used to be located on an aircraft's windshield. The product had to be light, but sturdy enough to withstand the stresses of atmospheric pressure. If the environmental stress skewed the visor readings, a pilot could send a missile in the wrong direction.

In the old days, Krevor would have started by thumbing through phone-book-thick plastics catalogs and consulting with GE techies. This time, he found the plastics he needed in an hour, rather than weeks. And he used GE's virtual lab to

M&M's Fancy teal-blue M&M's? Mars can deliver. A palette of 21 exotic colors is available by special order at the Mars Colorworks site. You pay nearly three times the price of regular M&M's, yet the business is doubling every year. Next up: Personalized logos that melt in your mouth.

check how the plastic flowed before he built an expensive mold that might not have worked. "It came much closer to the initial design, because we had the time to look at the best material available," Krevor says.

The upshot: Rockwell Collins cut its development time in half. GE Plastics avoids much of the back-and-forth between its technical team and customers, allowing it to reduce payroll and shift engineers to other work. It also can reach more customers faster. The company says it expects a third of the 5,000 new customer leads picked up from the Web site this year to become steady clients.

In industry and retail sales alike, victory in the marketplace of one demands flexibility—and knowing when to turn away from the Web. Nike's Nikeid.com, which lets shoppers design their own athletic shoes, has concluded that consumers want to try on sneakers similar to the ones they are ordering. So early next year, Nike will roll out Web kiosks in Niketown stores and encourage shoppers to become designers. "Size needs to be exact," says Jay Wilkin, general manager for Nikeid.com. "Not being able to try it on is a challenge for Web retailers."

Both cosmetics maker Reflect and Nike have had to overhaul production lines to spit out custom goods. Three-year-old Reflect created its own patented production process. It includes modular vats that can be swapped for different lotion or shampoo recipes. Nike's eight factories that make customized shoes have each gone through about a six-month rehaul.

The payoff, though, can stretch beyond sales. Masterfoods USA has picked up marketing ideas and is now testing NFL team colors in some retail markets. "It's an important part of the business," says Masterfoods' Simmons. For Christmas, along with the famous "M" on its candies, it will print messages such as "HO HO HO." Want to see your name on a batch of aqua-green M&M's? It could happen.

By Faith Keenan in Boston, with Stanley Holmes and Jan Greene in Seattle, and Roger O. Crockett in Chicago

BusinessWeek online

For more examples of online flops, as well as successes, go to the Dec. 2 issue online at www.businessweek.com.

How the Personal Touch Can Flop

YOU CAN'T TASTE THE PRODUCT

P&G's Millstone coffee used online surveys to personalize its java blends, but consumers had no guarantee the coffee would taste the way they imagined.

THE ITEMS ARE OVERPRICED

To squeeze out a profit, General Mills charged \$1.19 per serving for custom cereal, more than 2½ times the average cost of a bowl of breakfast food.

THE TARGET MARKET IS SMALL

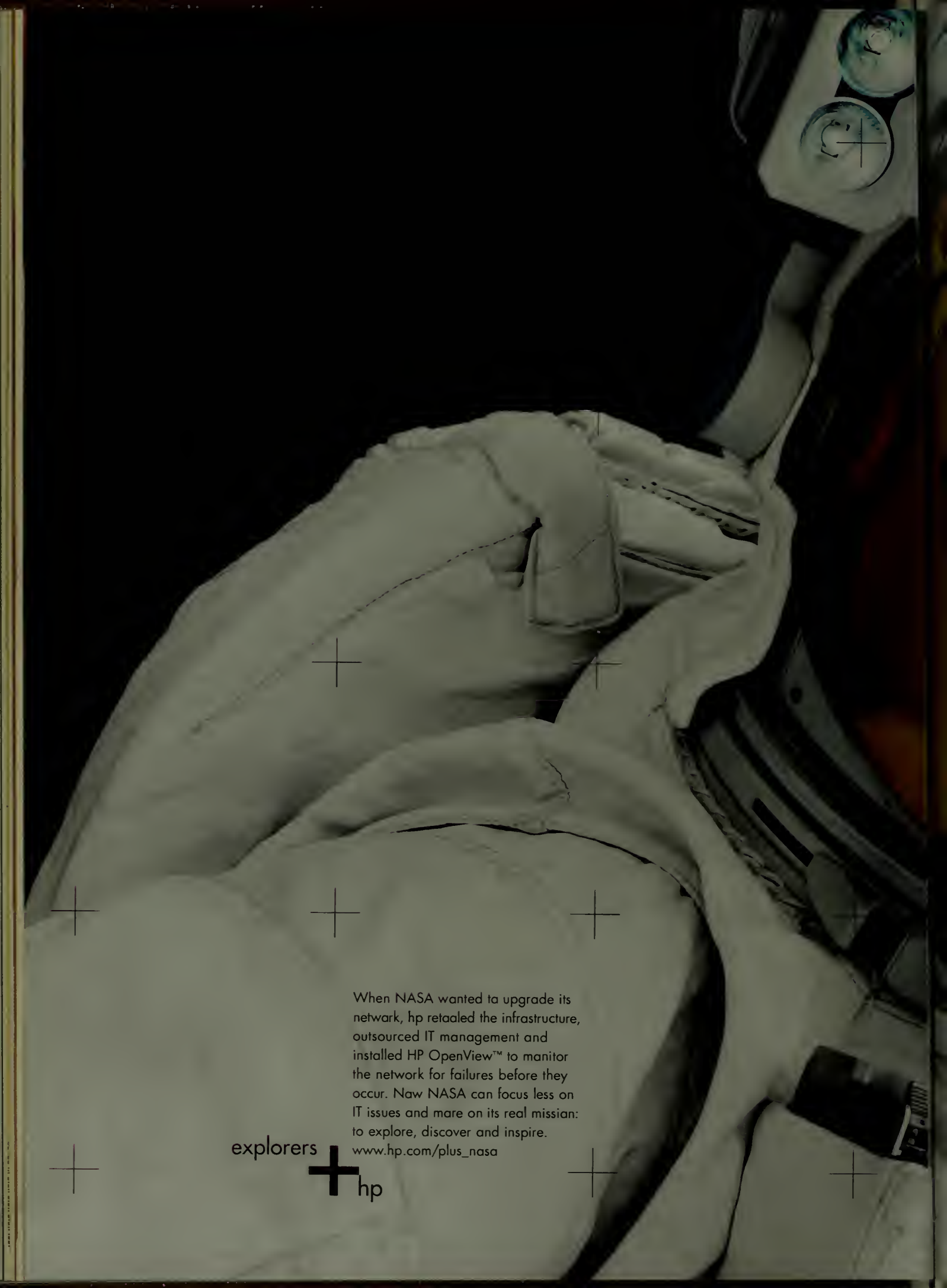
Less than 30% of high-income households—those most likely to buy custom products—have visited consumer-goods sites.

Data: Forrester Research Inc.

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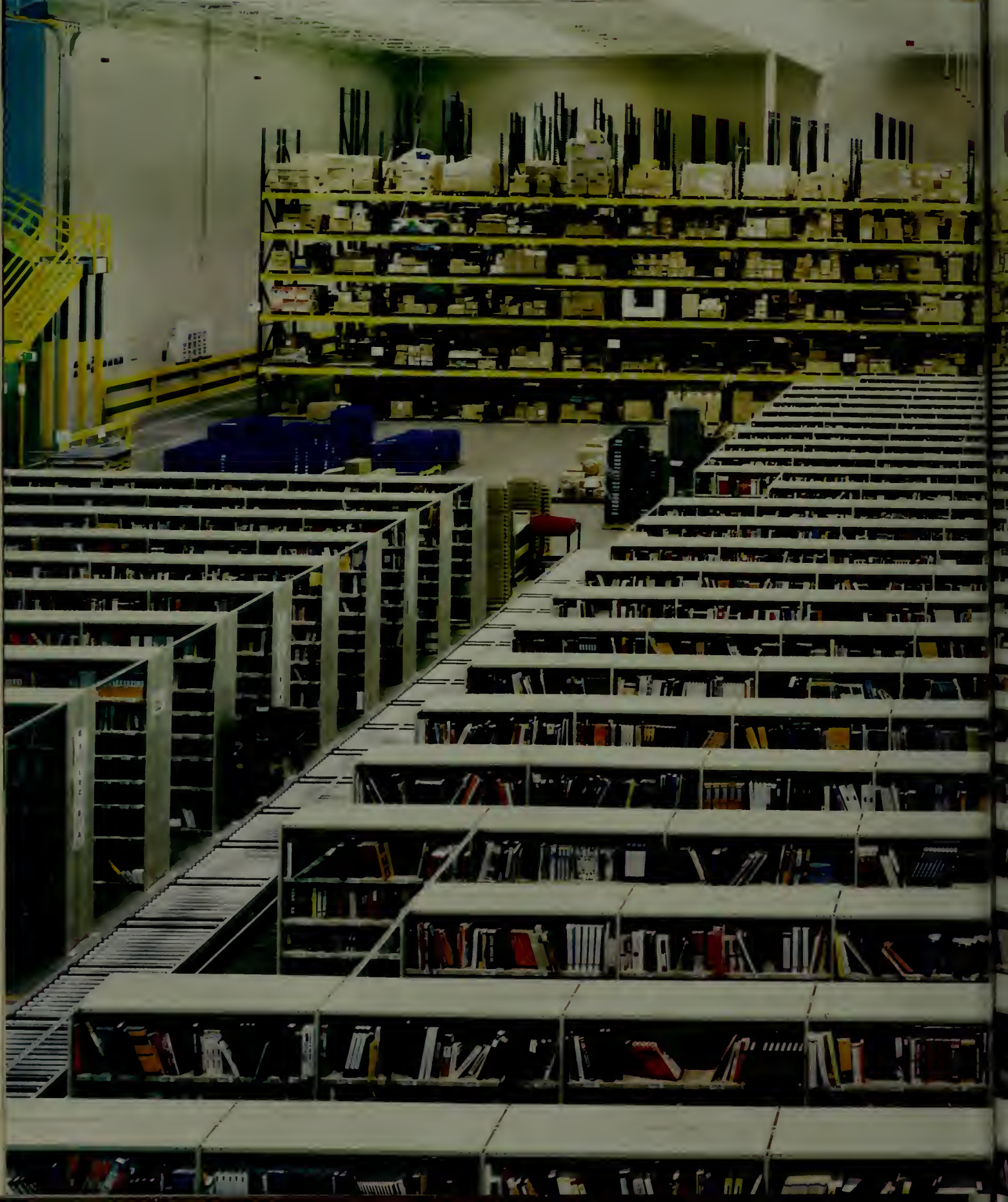
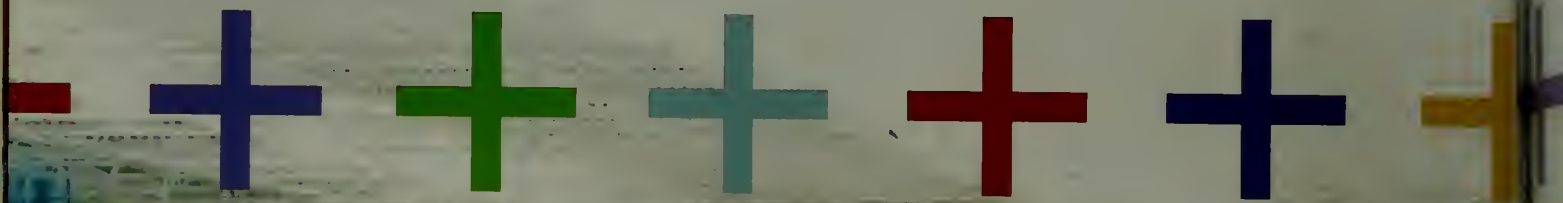


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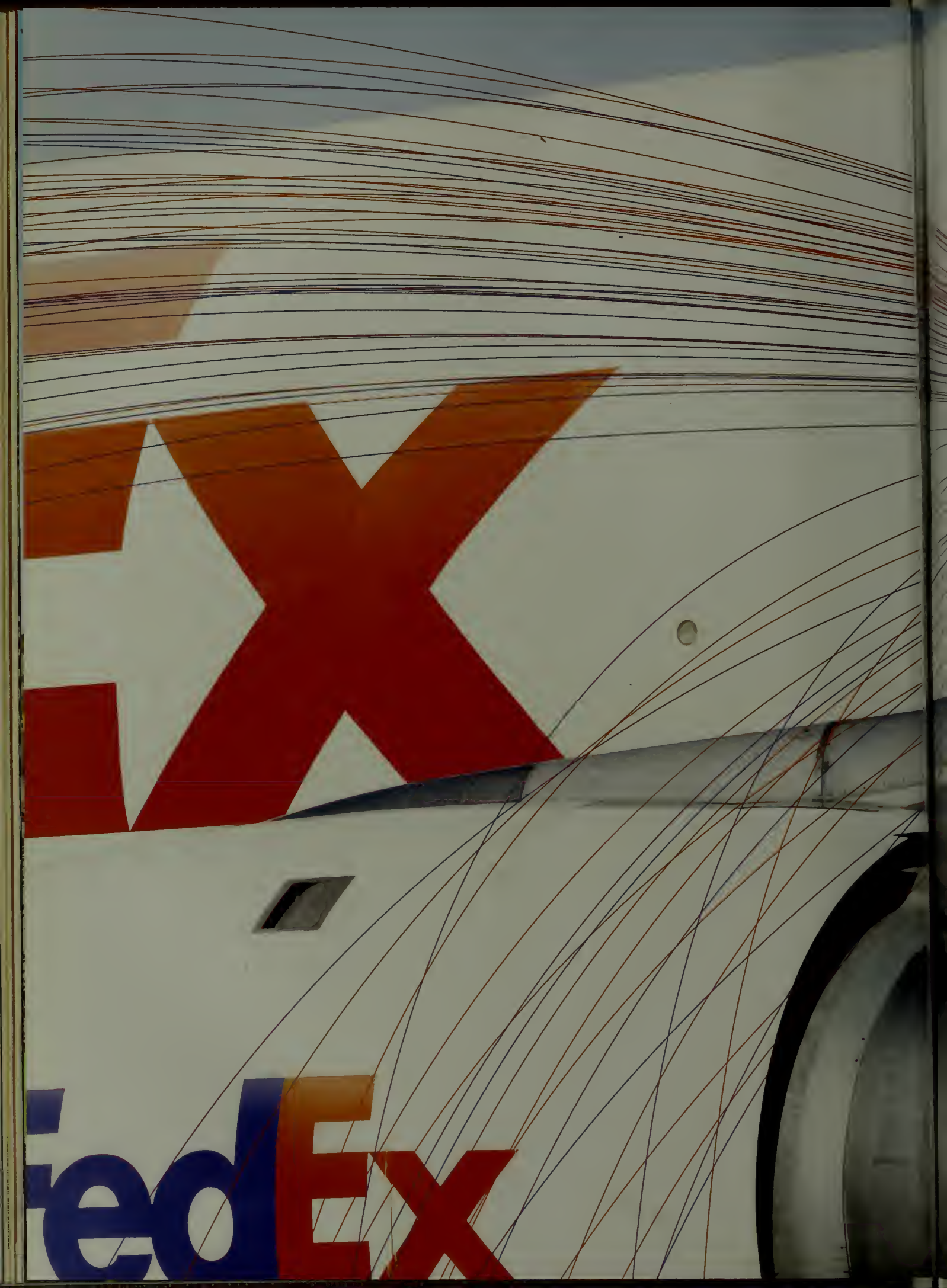


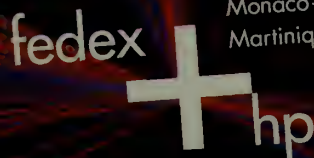
BirdLife Finland turned to hp and partner Nowire to develop the Bird Observation Service. Using GPS-equipped mobile phones, birdwatchers can instantly dispatch sightings with species and location information to a central database. This real-time information is a valuable conservation tool and indispensable to those in pursuit of the wily and elusive Oyster Catcher. www.hp.com/plus_birdlife

birdlife finland







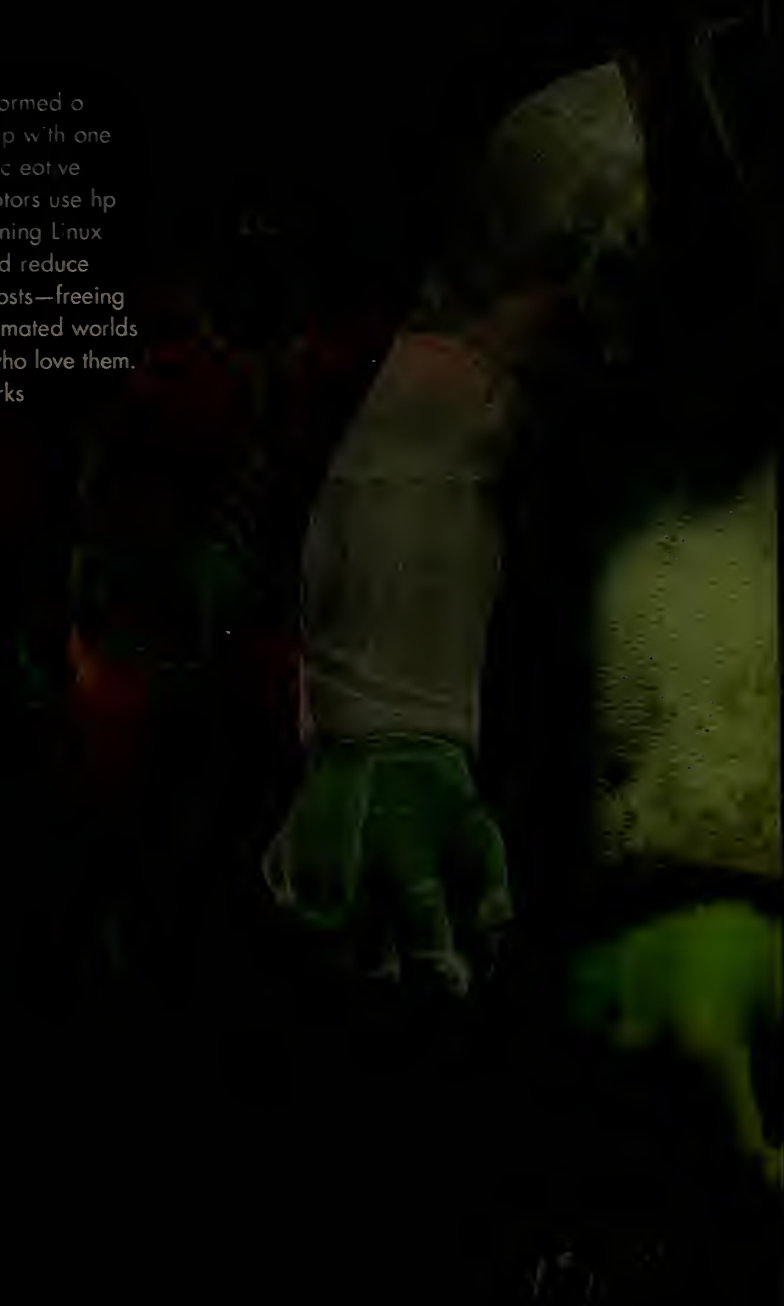


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GERSTNER'S SURPRISE

As Carlyle Group's chairman, he'll help the firm shed its image as a defense dealmaker

To the small universe that knows about it, Carlyle Group has an image right out of a John Grisham novel—a secretive firm of bigwigs that buys up lucrative defense businesses, wins hush-hush military contracts, and manipulates governments around the world to wring private profit out of public policy. It doesn't help that Washington-based Carlyle's payroll includes such former presidents as George H.W. Bush, Secretary of State James A. Baker III, British Prime Minister John Major, and Securities & Exchange Commission Chairman Arthur Levitt Jr.

Now Carlyle is about to scramble the conspiracy theories. On Nov. 21, it was expected to announce that Louis Gerstner Jr., the former CEO of IBM, will join Carlyle as chairman in January. In the real world, Gerstner's appointment has little to do with geopolitical intrigue. Instead, it's the clearest signal

yet that the firm has outgrown its old shell.

From its roots in defense, Carlyle has expanded rapidly into the world's largest private-equity manager. Drawn by its 36% annual returns, wealthy individuals and big institutions have committed \$13.9 billion for the firm to manage. Carlyle has always been more than a defense boutique, but now it is scooping up companies in a wider range of businesses—from the world's largest maker of artificial Christmas trees to semiconductors. And it's in the midst of closing the biggest buyout deal since RJR Nabisco Inc. in 1989—Qwest Communications' \$7.05 billion spin-off of its QwestDex Yellow Pages business.

Besides outgrowing its better-known Wall Street rivals—firms like Kohlberg Kravis Roberts & Co. and Blackstone

Group LP—Carlyle is hoping to outmaneuver them. It's pushing to become the first full-service private-equity manager, with 23 buyout, venture, real estate, and asset-management funds in North America, Europe, and Asia. If this unproven model can outperform the small deal shops that now dominate, Carlyle can become the Fidelity Investments of private equity.



CARLYLE'S A-LIST

Gerstner is joining a star-filled team. Below: Some of the luminaries on the firm's payroll

JAMES BAKER III

Senior Counselor



Secretary of State under George H.W. Bush, Baker joined Carlyle in 1993. Although not a dealmaker, he woos potential investors with his geopolitical insights.

GEORGE H.W. BUSH

Senior Adviser to the Asia Advisory Board



The former President serves on this board along with former Philippines President Fidel V. Ramos. Like Baker, Bush often speaks to potential investors.

FRANK CARLUCCI

Chairman, Carlyle Group



Defense Secretary under Reagan, he joined Carlyle in 1989, became chairman in 1993, and gave the firm its initial focus on the defense industry. He becomes chairman emeritus in January.

ARTHUR LEVITT JR.

Senior Adviser



The former SEC chairman joined Carlyle in 2001 to advise on its asset-management and hedge funds. Both are new additions to Carlyle's offerings.

JOHN MAJOR

Chairman, Carlyle Europe



The former British Prime Minister is an active player in Carlyle's overseas expansion with the European-buyout, venture-capital, and real estate funds.

With more than \$13 billion of the ultra-rich's money, Carlyle is now bigger than Kohlberg Kravis or Blackstone

vate equity, with one-stop shopping for institutions and individuals willing to invest at least \$5 million.

Gerstner will replace Frank C. Carlucci, Defense Secretary during the Reagan Administration, who has been with Carlyle since 1989 and becomes chairman emeritus. The former IBM chief hopes to provide strategic input on Carlyle's global activities and help guide the managers of companies that Carlyle buys to renew and rejuvenate. "I plan to advise the firm on what it does best—buying and managing companies—while helping Carlyle grow as an institution," Gerstner told *BusinessWeek*. The part-time advisory job—Gerstner is also committed to fostering education reform and studying Chinese history—will call on the same strategic and culture-building skills that helped him rescue IBM, albeit at a robust organization.

Gerstner won't be changing the basic direction set by Carlyle's co-founders: David M. Rubenstein, a lawyer and domestic policy adviser to President Jimmy Carter; William E. Conway Jr., once the CFO of MCI; and former Marriott executive Daniel A. D'Aniello. This triumvirate doesn't win much recognition. But they, and not the famous ex-politicos they've recruited, actually run the firm, heading a deep bench of 280 dealmakers in 21 offices worldwide.

The trio, known internally as DBD for their first initials, figures that Carlyle's diversified approach will build a private-equity firm that can outlast its founders. "Every pension or institution now invests in private equity," says Rubenstein. "To stay on top of their investment lists, firms like ours are going to have to become major institutions."

To make its strategy work, Carlyle will have to find advantages in its size for two constituencies: investors and dealmakers. The firm's brand name—and hefty returns in buyout funds—has indeed rubbed off on its other funds, appealing especially to foreign investors and families with, say, \$50 million to put into private equity. "Their franchise

gives them a real boost in raising funds, which is the key to this business," says Erik R. Hirsch, chief investment officer for Hamilton Lane, a private-equity investment consultant in Philadelphia.

But one-stop shopping doesn't necessarily enhance the firm's appeal to the huge U.S. pensions and endowments that provide the bulk of buyout and venture funding. "There's no particular advantage to us to have several fund options at one organization," says Robert Boldt, president of the \$13.2 billion University of Texas Investment Management Co., which has bought into Carlyle's domestic buyout funds but not its overseas or venture funds.

Charlotte (N.C.) info-tech buyout direct who structured a \$50 million deal 55% of the foundry. Watts, for his part, leaned heavily on Carlyle's Asian office for their semiconductor expertise. The new plant will use innovative processes to make chips for the next generation of cell phones and wireless networks and serve as a base for more chip design.

Carlyle also can draw on its financial strength. It has more than \$6 billion in cash because it cut back sharply on acquisitions when stock prices were high. But now that prices are back to earth, hard-hit public companies are scrambling to sell off units to bolster their balance sheets. The key to the QwestDex purchase, for example, was Qwest's urgent need for cash. While other bidders sought to break up the core network business, Carlyle and its partner, New York-based buyout firm Welsh, Carson, Anderson & Stowe, offered the fully financed bid for the whole operation. They paid only 7.9 times the unit's cash flow, versus multiples of 8.7 to 9 in similar recent deals.

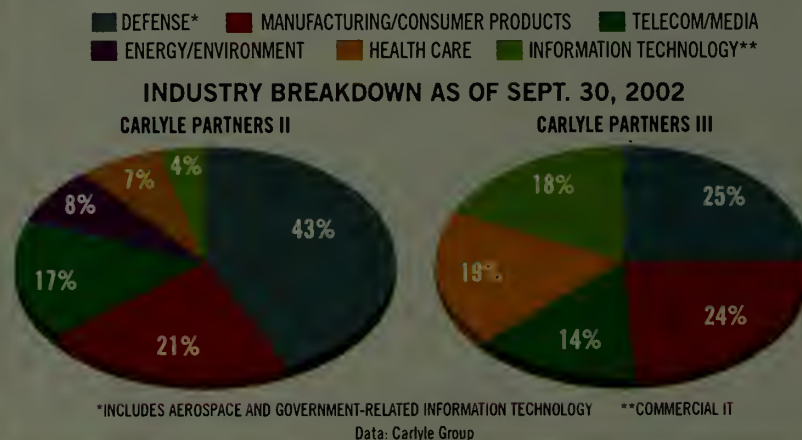
To help maintain discipline, Carlyle's partners put their own money into every investment. "Investors love it—we're taking the same risk they are," says D'Aniello. Moreover, the firm avoids auction where price alone determines the outcome. "A business that's clean, simple, easy to understand, ethical—you might as well sell that on eBay," quips co-founder Conway, the firm's chief dealmaker. Carlyle's expertise shows where it ends up the second- or third-highest bidder in an auction—and later prevails when more optimistic bidders drop out.

The co-founders joke that Carlyle's initial focus on defense was an accident of location: What credibility would a Washington-based firm have bidding on, say, a retailer? But the firm has long since proved its expertise in a wide range of endeavors. The arrival of business superstar Gerstner is just a reminder that at Carlyle success has not been accidental, but a matter of design.

By Mike McNamee in Washington

CARLYLE'S CHANGING MIX

Between Carlyle Group's mid-1990s U.S. buyout fund (Carlyle Partners II) and its current fund (Carlyle Partners III), the share invested in industries with close government ties—like defense, aerospace, and telecommunications—has shrunk:

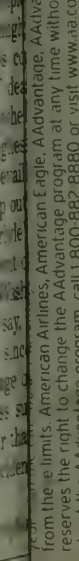
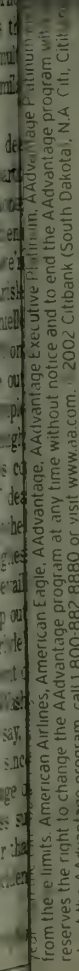


"If you have a blow-up in one area, it will affect the whole organization."

Other analysts note that although Carlyle's funds multiplied during the stock market's boom years, its venture funds, in particular, have struggled to find good investments in the technology downturn. "You'll be seeing some of those funds merge," predicts one adviser, who has limited his pension clients to Carlyle's buyout funds. Carlyle says it has no plans to consolidate its funds.

Carlyle's diversity, however, is proving its value on the dealmaking side. When semiconductor maker Conexant Systems Inc. approached Carlyle's San Francisco office to fund a spin-off of Conexant's wafer foundry, the venture-fund managers realized the deal was better suited for a buyout approach. They bounced it over to Claudius E. "Bud" Watts IV, a

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HORSE RACING

CAN SLOT MACHINES RESCUE RACING?

"Racinos" attract more bettors—and fatten state purses

Attendance at the nation's race-tracks has been declining for decades, leaving busted, empty tracks across America. Sales throughout the Thoroughbred breeding industry are faltering. And more than 30 states face a budget crisis this year.

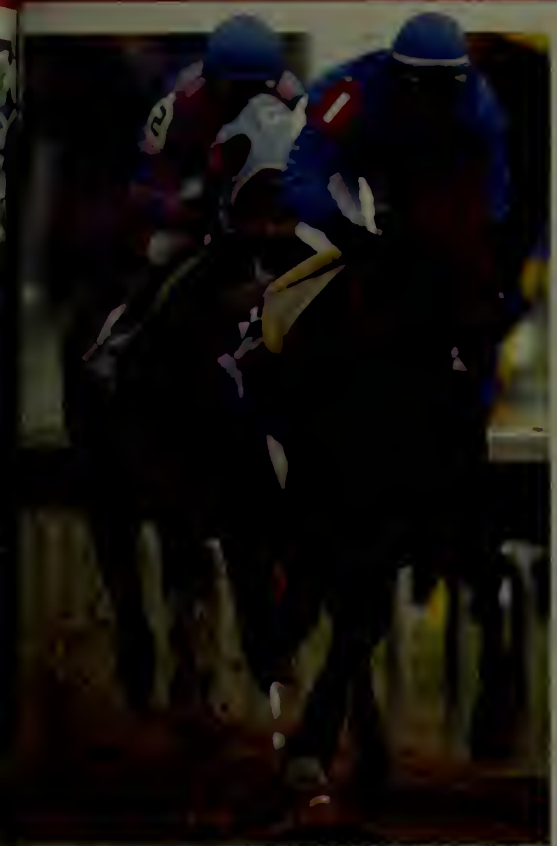
What's the connection? All three problems have one solution, say some racing enthusiasts and track financiers. And that solution is...the racino.

Racinos, tracks that have slot machines or video gambling terminals, have opened in six states—Delaware, Iowa, Louisiana, New Mexico, Rhode Island, and West Virginia—since 1999. New York's Aqueduct Racetrack, a subway ride from Manhattan, has permission to add up to 4,000 video terminals, but it hasn't figured out how to make money after the state takes its cut. Maryland and Pennsylvania are mulling legislation that would allow racinos, which ac-

count for much of the recent increase in betting on Thoroughbred races—up 12% since 1999, to an estimated \$15.3 billion this year.

Here's how racinos work, and why fans, breeders, and track owners like the idea: Racetracks install slots, generally thousands at a time, on-site. Racing fans, presumably between races, spend a few dollars on the slots. The income made by the track, after sizable payouts to the state and the lottery system, is funneled back in the form of bigger purses for each race. The difference between a racino-funded purse and one without slot money can be as much as \$175,000.

Big purses mean bigger paydays, attracting owners with better-performing ponies and creating more competitive races. In theory, that pulls in more bettors—many of whom use off-track and Internet outlets. So even though atten-



THE BREEDERS' CUP

After a computerized-betting scandal, Giuliani has been called in to develop safeguards

state budgets and the racing industry, they suck it out of surrounding communities, Thompson argues. Most racinos are not destination spots—they're frequented by locals. Says Thompson: "85% of the revenues will come from a 50-mile radius." That means other businesses get less.

Then there's the obvious drawback—more gambling. People who might not have come to the track are attracted by slot bonanzas, and die-hard rail birds are spending more money. Slots are much more addictive than the ponies, say gambling addiction experts, because the time between bet and payoff is so much smaller.

The recent Breeders' Cup scandal may do some harm to the very notion that the industry needs sav-

ing. On Nov. 20, one of three former fraternity brothers charged with rigging bets on the Oct. 26 Breeders' Cup to capture \$3 million in prize money pleaded guilty. The three—one of whom worked for Autotote, a company that processes computerized bets—allegedly used phone accounts and a computer to

pick the winners in six consecutive races. Former New York Mayor Rudy Giuliani and his consulting firm have been hired by the National Thoroughbred Racing Assn. to review the industry's electronic wagering system and help secure it.

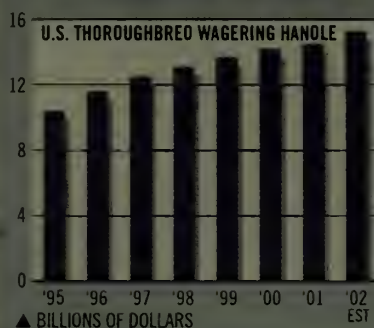
That's important because odds are the number of racinos will grow. "As the economy becomes more uncertain, people play more games of chance," says Michael Tew, a Bear, Stearns & Co. analyst. Besides, to strapped state governments and troubled tracks, racinos look like a sure thing on the daily double.

*By Heather Timmons
in New York*

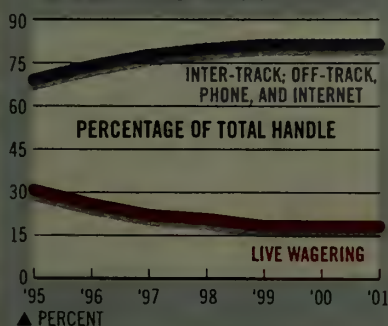
ance is down, tracks, which get a portion of every bet, make more money. You can take a nonprofitable track and make it profitable," says Jefferies & Co. gaming analyst Lawrence Klatzin. "[Racinos are] saving a dying industry." Indeed, the prospect of more racinos is helping to drive a consolidation trend.

Iagna Entertainment Corp. in Aurora, Ont. has bought five tracks in the last year, including Timlico in Baltimore. Some states have already become reliant on the income racinos pull in. In West Virginia, some 90% of the annual budget of about \$2 billion now comes from racino and other gambling. That infuriates antigambling lobbyists. "You cannot gamble yourself out of a business problem," says Glenn Thompson, executive director of Stand Up For Kansas, a group resisting a push by track owners there to turn their dirt miles into racinos. Although the tracks bring money into

BETTING ON THE PONIES IS RISING...



...BUT THE BUMP-UP HASN'T COME FROM RAILBIRDS



Data: Bear Stearns, Association of Racing Commissioners International

AMD

me.

COMMENTARY

By Mark Hyman

SALARIES ARE SLAMMING THE NHL. WHO'S TO BLAME?

Listen to NHL Commissioner Gary Bettman's dire warnings, and you might think the seconds are ticking down on hockey's collective-bargaining agreement. Well, they are, kind of. On Dec. 15, expiration will be a mere 21 months away.

In the National Hockey League, that's time to crown two more Stanley Cup champs and for the average defenseman to rack up three concussions and a busted nose. But is it time enough for Bettman to rescue the overheated economics of the NHL?

League revenues have risen from \$600 million to \$2 billion in the past 10 years. Yet player paychecks soak up 73% of revenues, up from 62% in 1997.

A lot of Third World countries have a better handle on inflation than pro hockey. A decade ago, an NHL player's average take-home pay was \$368,000. Five years ago, it topped \$1 million. Today, it's \$1.6 million. And that's in the face of a labor pool that expanded considerably since the Cold War ended and Russian players began to be drafted.

It's not just skating icons such as Peter Bondra and Mario Lemieux who are striking gold. When Bobby Holik, who hasn't scored more than 65 points in any one of his 12 years in the NHL, became a free agent last off-season, it was as if Wayne Gretzky was pulling on a jersey again. Teams concocted lavish offers, and the New York Rangers eventually wooed Holik with a deal worthy of the Great One: 5 years, \$45 million.

Now, Bettman is taking on a challenge as oversize as Holik's investment portfolio. He's trying again to sell the NHL Players Assn. on a salary cap—and he's suggesting that a deal be cut as soon as possible. That would mean opening the collective-bargaining agreement that ex-

pires in 2004. NBA and NFL players have yielded to comprehensive caps—that protect owners from their own impulsive spending. But hockey players have never given in.

At times, their resistance has been fierce. In 1994, the owners staged a 103-day lockout and still couldn't get

Bettman says he has sent a proposal to union chief Bob Goodenow. (He says he hasn't received it.) And Bettman professes optimism that his sense of urgency "is getting through" to Goodenow and the players.

Maybe so. But the players don't show any sign of softening. "We dealt with this issue during the lockout. We don't believe a cap is in the best interest of the sport," says Goodenow. "There should be a marketplace. The clubs and players should have the ability to decide values."

"Free markets don't have minimum salaries. Free markets don't have salary arbitration," sniffs the commish.

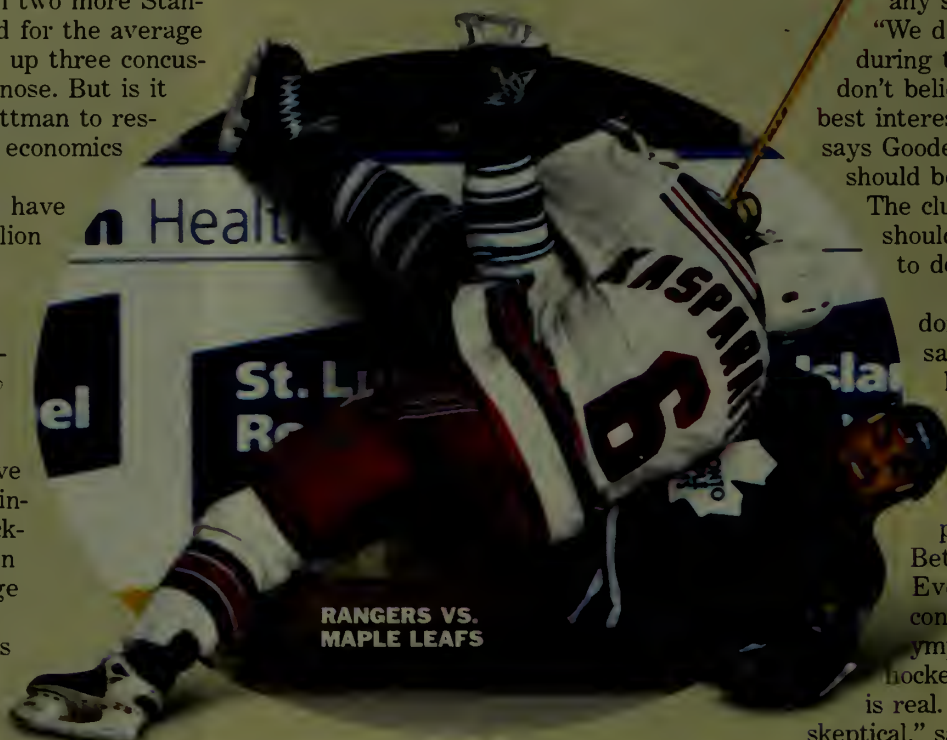
Rhetorical points will get Bettman only so far. Eventually, he has to convince players and sympathizers that hockey's financial crisis is real. "Of course I'm

skeptical," says John Palmer, a professor of sports economics at the University of Western Ontario. "If most hockey franchises weren't profitable, you'd have to assume there are a lot of idiots out there paying \$100 million for a franchise to lose money."

Maybe there are. "Management incompetence amazes me. These are businesspeople supposedly planning years ahead. But their long-term plan is like my daughter's—a day long," says agent Rich Winter, whose clients include Bondra.

Bettman will, no doubt, keep jawboning about the salary time bomb, but that will probably be as effective as crying for help in Madison Square Garden right after the Rangers score. Odds are that the issue will go down to the wire. When that happens, watch out for the high sticks.

Hyman is contributing editor for Sports Business.



"Management incompetence amazes me. These are businesspeople supposedly planning years ahead. But their long-term plan is like my daughter's—a day long"

RICH WINTER

Agent for the Washington Capitals' Peter Bondra

a cap. But without a cap, Bettman argues, "the league, in its current form, may not be recognizable.... Some [of the 30 teams] will run out of gas." Waiting two years to fix the contract, he adds, will only drive some franchises deeper into debt. Among those on the thinnest of ice are the Ottawa Senators and Florida Panthers.

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EXECUTIVE SUITE

MICHAEL STAYS IN THE PICTURE

How Eisner is stumping to bolster Disney—and himself

Patrick McGurn can “count on one hand” the number of CEOs who have stopped by his Rockville (Md.) office in recent years for a chat. Now McGurn, senior counsel of shareholder rights group Institutional Shareholder Services, can add Michael D. Eisner to the list. In late September, the Walt Disney Co. chairman made the 45-minute trek from Washington, D.C., a DVD of Disney’s *The Rookie* in hand, to lobby McGurn, whose group has been a vocal critic of Eisner’s tight grip on his board. “He scored points

investment conference in early October. “But this has also been a period of investment...that I am confident will pay off well in the years ahead.” Eisner declined to comment for this story.

There’s little evidence that Eisner has completely won over investors’ hearts and minds. But the buzz about his imminent departure has largely quieted, indicating he has weathered the storm for now. “He’s a brilliant in-fighter,” says Porter Bibb, a managing partner with merchant bank Technology Partners Holdings, which is considering

buying Disney shares after staying on the sidelines for months. And a few larger investors are starting to buy, encouraged as much by the firming TV ad market as anything that Eisner may be pitching. Two of Disney’s larger shareholders, Southeastern Asset Management Inc. and State Street Research & Management Co. said in September Securities & Exchange Commission filings that they had increased their stakes in the Mouse House. That has helped boost Disney’s stock price by 22%, to \$18.23, since mid-September. “The worst may be over for him, and the economy will help

this company,” says State Street fund manager Larry Haverty Jr., who figures Disney’s stock could pass \$21 in the coming year.

Eisner is carrying out his self-preservation crusade on several fronts, say in-

siders. Besides stepping up his public appearances, he ran to the head of the corporate-governance parade in April, hiring well-known governance attorney Ira M. Millstein, a partner at law firm Weil, Gotshal & Manges LLP, and agreeing to make substantial changes to a board often decried for its close ties to the CEO. As many as four board members are expected to leave, cutting the 16-person board to 12, as suggested by Millstein. Among them: Reveta F. Bowers, who runs the school Eisner’s sons attended. The Disney board is also contemplating Millstein’s suggestion to appoint a “lead director” to speak for Disney’s independent board members.

Eisner’s biggest score, however, was in quieting his most vocal in-house critic, board member Stanley P. Gold, the 59-year-old business partner of

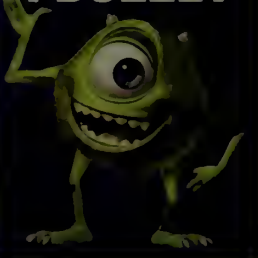


RATINGS RISE: John Ritter in a new ABC show

just by making the trip,” says McGurn.

The hour-long sit-down is part of 60-year-old Eisner’s campaign to boost his company and to keep his job, say those close to the company. Since mid-September, the Disney CEO, under pressure to improve performance, has crisscrossed the country like a politician running for re-election, setting down the corporate jet to press the flesh with investors in New York, Boston, and Washington, D.C. His stump speech hammers home two big points: The ABC network is on the rebound, and all the theme parks need is for the depressed post-September 11 travel economy to improve. “The past five years have been disappointing in terms of earnings and stock price, and I take responsibility,” Eisner said in one well-rehearsed line at a Goldman Sachs

DODGING A BULLET



EISNER IS ON THE OFFENSIVE...

■ Jetted back and forth across the country to talk up Disney’s long-term strategy with investors over lots of lunches and dinners

■ Recruited governance expert Ira Millstein and began to overhaul his board of directors’ practices after being criticized by shareholder groups

■ Brought in new brass at the troubled ABC network, which this year has had some early hits with *8 Simple Rules for Dating My Teenage Daughter* and *Life With Bonnie*



founder Walt's nephew, Roy. At a contentious meeting in late September, board members lined up with Eisner, accusing Gold of fanning disparaging press stories. Over Gold's objections, the board then effectively demoted him, naming

former U.S. Senator George J. Mitchell to co-head with Gold the board's important Governance & Nominating Committee. Gold, who was lining up support among Disney board members to pressure Eisner, has now "stood down," says a Gold associate. Gold declined to comment.

Even before the Gold challenge, Eisner was stepping up his campaign. Disney's public-relations executives began zipping off daily e-mails to the press, ballyhooing small successes at ABC even while overall ratings continue to decline. Among the high points: Households tuning in are up 4% for *Monday Night Football*, and viewers aged 18 to 34 on Tuesday nights, anchored by the John Ritter comedy *8 Simple Rules for Dating My Teenage Daughter*, have increased by 36% over the past year.

Eisner and his Team Disney are promoting film successes, too, like the low-budget Reese Witherspoon comedy *Sweet Home Alabama* and this summer's *Lilo & Stitch*, the biggest Disney-made animated hit in three years. The studio and better-than-anticipated theme park attendance increased Disney's fiscal fourth-quarter earnings to \$222 million, up from \$53 million last year. The company now projects 20% earnings growth for next

year. "We have things that are going well, and we want to get the word out," says Disney Chief Financial Officer Thomas O. Staggs. Execs talked of putting Eisner in front of more shareholders two years back, says Staggs, but he is only now increasing his appearances.

The Eisner campaign took off in mid-September, when the Disney CEO held three New York meetings in 24 hours, talking to analysts and investors. "He looked beat up. But he wasn't in his bunker, and that's a plus," says John Tinker, an analyst at Blaylock & Partners LP. Tinker and other analysts chowed down on burritos at ABC's Times Square studios as Eisner pitched the network lineup. Two weeks later, when theme park chief Paul Pressler quit, Eisner was back in New York for a conference and to chat up analysts. Warding off concerns about defections among Disney's upper management, Eisner boasted of his company's "deep bench," wrote J.P. Morgan Chase & Co. analyst Spencer Wang following a private dinner with the CEO.

Wang, who rates Disney "neutral," isn't ready to declare Eisner the victor yet. Not a lot of folks are. The company still has possible potholes ahead. Sales of Disney consumer products are still off, and the company likely will have to give up more profits when it renegotiates its deal with Toy Story creator Pixar Animation Studios. Higher than expected sports program costs have cut into its usually reliable ESPN channel, prompting some analysts to lower first-quarter projections. ABC and the theme parks, of course, are still big question marks.

But for now, Eisner's biggest critics are largely cooling their heels. Just listen to Bert Denton, whose Providence Capital Inc. unit earlier this year tried to drum up support among dissatisfied Disney shareholders to overhaul the company's board policies and who chatted on the phone on Nov. 14 with Disney brass. "Disney's stronger stock price took some of the wind out of our investors' sails," concedes Denton. But he says he still intends to press Disney to consult shareholders when it brings on new board members. "Let's see where Eisner is in a year if this company hasn't improved," he says. Until then, Eisner is certain to stay on the campaign trail.

By Ronald Grover in Los Angeles

...AND WALL STREET IS LISTENING



BusinessWeek online

For a related commentary on the ABC-CNN proposed merger, go to the Dec. 2 issue at www.businessweek.com.

Today's donors are more ambitious, get more involved, and demand results

BY JOHN A. BYRNE

"Rich men should be thankful for one inestimable boon. They have it in their power during their lives to busy themselves in organizing benefactions from which the masses of their fellows will derive lasting advantage, and thus dignify their own lives."

When industrialist Andrew Carnegie wrote those words in 1889, he believed that the rich had a moral obligation to give away their fortunes. The legendary steel tycoon asserted that all personal wealth

beyond a family's needs should be regarded as a trust fund for the benefit of the community. Further, he believed that the money should be given during the benefactor's lifetime to ensure that it accomplished the maximum good.

Carnegie would surely have given an approving nod to the latest generation of philanthropists. Not since the Gilded Age, when harsh overlords such as Carnegie and John D. Rockefeller Sr. put millions of their dollars toward good works, has philanthropy been as bold and ambitious. The spectacular late-1990s runup in the stock market created a generation of newly super-rich executives and

THE NEW FACE OF

PHILANTHROPY



(L TO R) PHOTOGRAPHS BY LEE LOCKHART/ATLANTA JOURNAL-CONSTITUTION, UNDERWOOD & UNDERWOOD/CORBIS

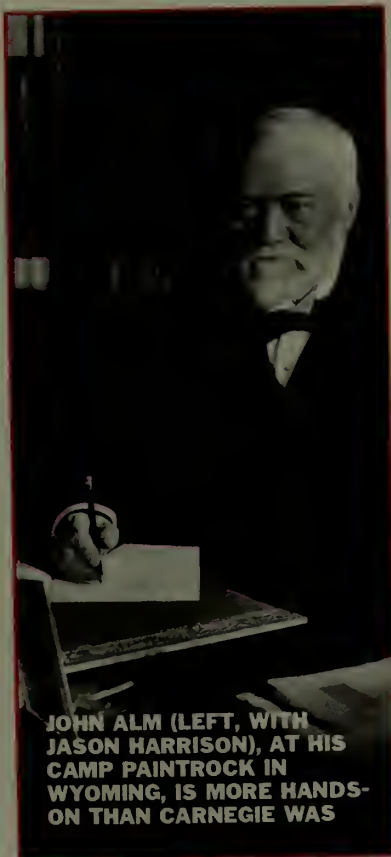
GREAT MOMENTS IN GIVING



entrepreneurs worth hundreds of millions, if not billions, of dollars. Even after the sharp decline in the market, the ranks of the very wealthy have never been stronger—and many are now working almost as hard at giving their fortunes away as they did at amassing them. Since 1990, charitable donations by individuals have grown by half, from \$110 billion to \$164 billion in 2001. By harking back to the individualistic style of giving practiced by Carnegie, these donors are ushering in a new era of philanthropy.

This new philanthropy displays an impatient disdain for the cautious and unimaginative check-writing that dominated charitable giving for decades. So what does it look like?

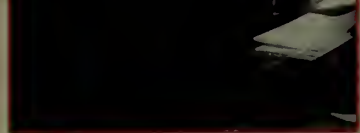
- It's more ambitious: Today's philanthropists are tackling giant issues, from remaking American education to curing cancer.
- It's more strategic: Donors are taking the same systematic approach they used to compete in business, laying out detailed plans that get at the heart of systemic problems, not just symptoms.
- It's more global: Just as business doesn't stop at national borders, neither does charitable giving. Donors from William H. Gates III to George Soros have sweeping international agendas.
- It demands results: The new philanthropists attach a lot of strings. Recipients are often required to meet milestone goals, to invite foundation members onto their boards, and to produce measurable results—or



JOHN ALM (LEFT, WITH JASON HARRISON), AT HIS CAMP PAINTROCK IN WYOMING, IS MORE HANDS-ON THAN CARNEGIE WAS

PHILANTHROPY

1889 Industrialist Andrew Carnegie writes *The Gospel of Wealth*, an essay calling upon the very rich to give their fortunes away during their lifetimes. Carnegie ultimately gave away virtually all of the wealth he created, some \$350 million, or in today's dollars, roughly \$3 billion.



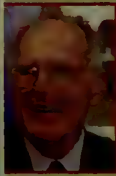
risk losing their funding. All of this requires a new level of involvement by donors. More than just ribbon-cutters, the new philanthropists are actively engaged in projects that become passions. John R. Alm is one example. The president of Coca-Cola Enterprises Inc. has taken an ambitious goal—providing ongoing, intensive support to at-risk kids in inner-city Los Angeles, from middle school through college—drawn up a plan, and now devotes a large portion of his time outside the office to making that plan work.

The start of this new era can be traced to late September, 1997, when cable-TV mogul Ted Turner anted up an historic \$1 billion pledge to the U.N.—and challenged wealthy “skinflints” to do likewise. The nation’s underachieving billionaires got an even bigger prodding two years later when the world’s richest man, Bill Gates, pumped a staggering \$16.5 billion into his foundation to help pay for a campaign to improve health

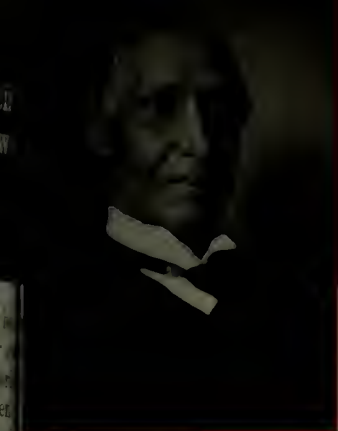
care for the world’s poor. Gates and his wife Melinda have since poured a total of \$25.6 billion—some 60% of their current net worth—into their foundation, making it the world’s largest. Their mission to bring vaccines to poor children in Africa and India is as strategic and sweeping as Carnegie’s promise to build a library in every American town.

To track who’s who in this new world, *BusinessWeek* has ranked 50 of the most generous donors in America. Using public records and interviews, we’ve tallied donations going back five years as well as total contributions and pledges. Then, because generosity is a relative term depending on the size of the pot, we’ve looked at total giving as a percentage of current net worth. Naturally, there are limitations to our methodology, the main one being that many wealthy donors prefer to give anonymously—and take great pains to make sure their gifts are never identified. What our ranking does show, though, is that many of the new philanthropists are willing to back their bold plans with substantial portions of their personal wealth. Together, this group has given \$41 billion

THE 50 MOST GENEROUS PHILANTHROPISTS

NO.	NAME	BACKGROUND	1998-2002 GIVEN OR PLEDGED MILLIONS	CAUSES	ESTIMATED TOTAL GIVING* MILLIONS	CURRENT NET WORTH** MILLIONS
	1. BILL & MELINDA GATES	Microsoft co-founder	\$23,500	Health, education	\$25,600	\$43,000
	2. GORDON & BETTY MOORE	Intel co-founder	5,130	Conservation, education	6,600	3,300
	3. JAMES & VIRGINIA STOWERS	American Century founder	1,450	Biomedical research	1,500	575
	4. ELI BROAD	SunAmerica founder	1,045	Public education, arts	1,100	4,800
	5. THE WALTON FAMILY	Family of Wal-Mart founder	750	Education	1,000	94,000
	6. GEORGE SOROS	Investor	536	Open & free societies	2,000	7,000
	7. MICHAEL & SUSAN DELL	Dell Computer founder	510	Children's health care	525	11,200
	8. TED TURNER	CNN founder	508	Health, environment	1,400	2,200
	9. PAUL ALLEN	Microsoft co-founder	410	Art, culture	425	21,000
	10. DONALD BREN	Real estate	400	Education, environment	410	4,000
	11. PATRICK & LORE MCGOVERN	IDG founder	350	Brain research	370	2,000
	12. JOHN KLUGE	Metromedia founder	300	Library of Congress	750	10,500
	13. MARTHA INGRAM	Widow of Ingram founder	300	Education, arts	638	2,300
	14. DAVID & CHERYL DUFFIELD	PeopleSoft co-founder	275	Animal humane societies	300	1,300
	15. SIDNEY KIMMEL	Jones Apparel chairman	261	Health care, arts	420	750
	16. TOM MONAGHAN	Domino's Pizza founder	260	Catholic education & services	285	350
	17. JAMES ROGERS	Sunbelt Comm. founder	260	Higher education	270	550
	18. PETER LEWIS	Ex-CEO Progressive	255	Education, arts	476	1,300
	19. WILLIAM COLEMAN	Chairman, BEA Systems	250	Higher education	252	100
	20. ALBERTO VILAR	Investor	225	Arts, culture	225	900
	21. KIRK KERKORIAN	Investor	215	Armenian causes	250	4,500
	22. SANDY & JOAN WEILL	Citigroup CEO	215	Higher education, arts	220	1,100
	23. WARREN & SUSAN BUFFETT	Berkshire Hathaway CEO	201	Nuclear threat initiative	230	36,000
	24. ALFRED MANN	MiniMed chairman	200	Bioengineering	270	950
	25. DAVID GEFFEN	DreamWorks co-founder	200	Medical education	210	3,800

■ For an explanation of our ranking methodology, see page 86



1907 After the death of investment banker Russell Sage, his widow, Margaret Olivia, creates the first of the large, modern, general-purpose foundations. The Russell Sage Foundation continues to fund projects "for the improvement of social and living conditions in the United States."

over the past five years.

The other names on *BusinessWeek's* Top 50 are no less sweeping in their goals than Gates. Los Angeles bil-

naire Eli Broad, No. 4 in the ranking, is giving hundreds of millions to help reform urban school districts and train a new generation of educational leaders. Hedge-fund manager George Soros, No. 6, has funneled hundreds of millions to support what he calls "open societies" around the world that embrace freedom of speech and religion. Gordon Moore, co-founder of Intel Corp. and No. 2 on *BusinessWeek's* list, recently pledged \$5 million to halt the possible extinction of salmon in the Northern Pacific Rim. And former Netscape Communications Corp. CEO James Barksdale, No. 36, is giving \$100 million to improve literacy among children in his native Mississippi.

For every one of these big-money donors, there are hundreds of other individuals below this radar screen who have embraced philanthropy in creative new ways. That's why

we're also including a table of the nation's most innovative givers. Catherine S. Muther, a former Cisco Systems Inc. executive, has launched an incubator to help nonprofit startups in San Francisco. Mario Morino, a former high-tech entrepreneur, is using a venture-capital approach to fund nonprofits that assist inner-city children in the Washington (D.C.) area. Jeffrey Skoll, former president of eBay Inc., is giving \$150 million to help already-suc-

cessful nonprofit leaders expand their work. These new philanthropists are determined to donate their fortunes not on their deathbeds but during their lifetimes. Doing so allows them to undertake important projects sooner and to exert more control. "That is unheard of," says Doug Lawson, a longtime fund-raiser and consultant. "Most of the big money was always given by people over 65."

It is also clear that there are plenty of wealthy laggards (table, page 94). The second-richest man on earth, superin-

Cover Story

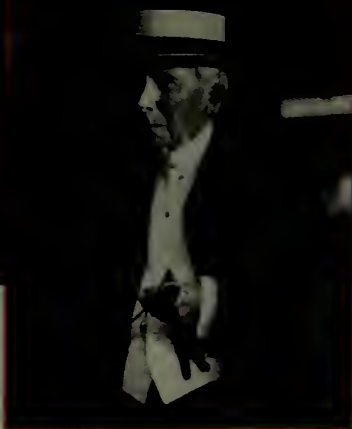
NO.	NAME	BACKGROUND	1998-2002 GIVEN OR PLEDGED MILLIONS	CAUSES	ESTIMATED TOTAL GIVING* MILLIONS	CURRENT NET WORTH** MILLIONS	% OF WEALTH DONATED†
26.	JOHN JACKSON	Katie Petroleum co-founder	\$195	Education and health care	\$220	\$350	63%
27.	JON HUNTSMAN	Huntsman founder	165	Cancer research, Wharton	350	2,500	14
28.	RUTH LILLY	Eli Lilly heiress	150	Poetry, libraries, culture	280	800	35
29.	JAMES CLARK	Netscape co-founder	150	Biomedical engineering	175	670	26
30.	JEFFREY SKOLL	Ex-president of eBay	149	Social services	165	2,300	7
31.	IRWIN & JOAN JACOBS	Qualcomm co-founder	142	San Diego Symphony	160	725	22
32.	PIERRE & PAM OMIIDYAR	eBay chairman	140	Building community	160	4,400	4
33.	LEON LEVY	Investor	130	Education	140	750	19
34.	KENNETH BEHRING	Real estate	123	Smithsonian, wheelchairs	125	450	28
35.	JOAN KROC	Widow of McDonald's founder	105	Salvation Army, education	275	1,800	15
36.	JAMES & SALLY BARKSDALE	Netscape co-founder	103	Education & literacy	150	450	33
37.	ROBERT & TOM PRITZKER	Hyatt Hotels & real estate	100	Education	450	15,200	3
38.	JEROME FRAUTSCHI	Webcrafters ex-vice-chairman	100	Arts & culture	110	470	23
39.	RALPH & BETTY ENGELSTAD	Vegas hotel owner	100	College sports	110	500	22
40.	PHILIP & DONNA BERBER	CyBerCorp.com founder	100	Antipoverty in Ethiopia	100	250	40
41.	MIKE LAZARIDIS	BlackBerry developer	100	Theoretical physics institute	102	1,900	5
42.	KENAN SAHIN	Kenan Systems founder	100	Higher education	100	260	38
43.	BERNARD MARCUS	Home Depot co-founder	91	Children's health, aquarium	350	1,800	19
44.	AUDREY JONES BECK	Oil heiress	80	Art museum	200	400	50
45.	FRANK BATTEN SR.	Ex-chmn., Landmark Comm.	75	Higher education	105	1,200	8
46.	TED FORSTMANN	Co-founder Forstmann, Little	75	Disadvantaged children	100	775	13
47.	FREDERICK KLINGENSTEIN	Investor	75	Health care, museums	95	350	27
48.	CHARLES BAUER	AIM Funds co-founder	72	Education	72	500	14
49.	ARTHUR & ANGELA WILLIAMS	Insurance-company founder	70	Liberty University	80	1,300	6
50.	FRANK LEVINSON	Finisar founder	65	Religion, science, education	70	600	12

*Based on public records and interviews with donors

**Based on *Forbes* 400 list and *BW* estimates

†Donations as a percent of current net worth

Data: *BusinessWeek*, Center for Philanthropy, *Chronicle of Philanthropy*, various news sources



1913 John D. Rockefeller creates the Rockefeller Foundation and eventually gives away \$540 million (about \$6 billion today's dollars) during his lifetime. His son, John D. Jr., contributed nearly the same amount, establishing the Rockefellers as one of the nation's best-known philanthropic families.

investor Warren E. Buffett, has so far given about \$230 million, making him No. 23 on our ranking. But that's only 0.6% of his current \$36 billion in personal wealth, which is mostly in Berkshire Hathaway Inc. stock. That puny percentage also puts him on our list of laggards. Buffett, 72, says he plans to pass his stock to his foundation after his death and that the best thing he can do for any causes it may someday fund is to make as much money as possible before then. That could pose some problems. The Bill & Melinda Gates Foundation, considered one of the leanest, has a

Cover Story

staff of 230. A Buffett charity could have an endowment that's even bigger—with almost no infrastructure in place.

Or consider the Waltons. The family of Wal-Mart founder Sam Walton has given a whopping \$1 billion to charity. But that's barely more than 1% of their \$94 billion fortune. Most of that consists of their 38% stake in Wal-Mart, a stake they consider sacred. They base their giving, instead, on the \$500 million pretax income it throws off each year.

Similarly, Oracle Corp. founder Lawrence J. Ellison to date has given less than \$100 million, even though he has amassed a fortune worth \$15.2 billion. Ellison, who does support medical research on aging, says results count more than the size of the gift. "Until you start solving problems, until you start curing diseases, until you start delivering results, what difference does it make how much you give?" said Ellison at a *BusinessWeek* forum in New York last year.

The surge in private donations, which has more than doubled the number of grant-making foundations since 1987, to more than 56,600, is a harbinger of what's likely to be an even bigger period of growth in American philanthropy. If the trends of the past quarter-century continue, charitable giving in this decade alone could be a trillion dollars more than it was in the previous one,

MUTHER (IN SCARF) WITH DENISE HERRERA, NIKO CLIFFORD, AND BECKY HO OF GIRLS FOR A CHANGE



says Erik D. Smith, author of a recent Global Business Network report on philanthropy. The coming philanthropic flood adds Smith, "would be similar to having a hundred And Carnegie's library giving spanned."

A good chunk of this will come from recently established foundations that will receive their principal endowments over the next 15 years. EBay founder Pierre M. Omidyar, for example, has put only a fraction of his \$4.4 billion net worth into his foundation—little more than \$50 million—even though he says he plans to give away all but 1% of his wealth before his death. Home Depot Inc. founder Bernard Marcus, has given only \$350 million of his \$1.8 billion fortune, most of which he also says he intends to hand out in his lifetime.

Many of the new class of super-rich aren't waiting until retirement to start giving back. Instead, they're starting innovative programs that in essence become second careers. eBay's Skoll, 37, has developed a strategy not unlike

HOW WE RANK THEM

It's not easy to put a figure on a person's generosity. Many charitable donations are given anonymously, with little or no fanfare. The reports of foundations run by individuals are often filed late—and much giving can flow straight from the donor's pockets anyway. So to compile *BusinessWeek's* first ranking of the most generous philanthropists, we relied heavily on news reports of publicly announced gifts, press releases, foundation filings, and interviews with people in the field of giving. The Top

50 are ranked by what they have pledged or given in the past five years. We also estimate each person's total contributions as well as the percentage of his or her current net wealth that has been given away as a measure of his or her generosity.

To compile a list of possible philanthropic laggards, we started with the most prominent multibillionaires and then looked for news reports and public records of their charitable contributions. The people on our list rarely, if ever,

turned up as donors—or gave so little relationship to their wealth that they appeared miserly. Most of them maintain that they give substantial sums but privately. In some cases, we were able to verify significant gifts, and those people were removed from the list (page 94).

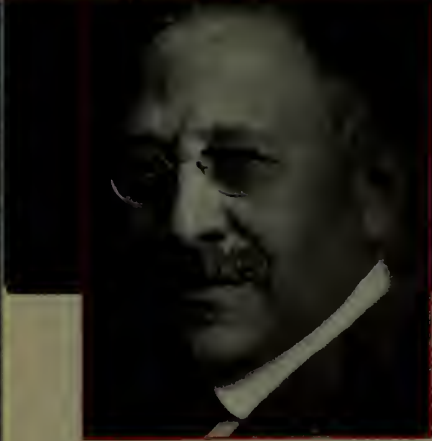
To identify the most creative philanthropists, we asked dozens of people in the giving industry to name the most innovative donors (page 90). We screened the candidates and made our selections.



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1929 Sears Roebuck President Julius Rosenwald argues that a foundation should spend itself out of existence within a generation to avoid "the building up of bureaucratic groups of men who tend to become overconservative and timid." His own trust spent itself out within 15 years of his death in 1932.

the world, nonprofit leaders who have already made a difference on a local or regional basis and need capital to take their idea to the next level. "We're trying to create long-term partnerships with these folks," says Skoll, No. 30 on *BusinessWeek's* list. "Our hope is to find real inflection points in their work where we can partner with them to make them more successful."

Cover Story

One recent example is a \$300,000 grant to Martin Fisher, who created a nonprofit company in Kenya 10 years ago. It develops cheap technologies, from irrigation pumps to earth-digging equipment, and makes them available to poor farmers for as little as \$18. Fisher's nonprofit has been so successful in transforming the lives of Kenyan workers that it is contributing 0.5% of Kenya's gross national product.

While Skoll systematically sifts the nonprofit world for high-impact initiatives, other new philanthropists are driven to projects by a searing personal experience. James E. Stowers Jr., founder of American Century Services Corp., an asset-management firm, has put an extraordinary \$1.5 billion of his money—roughly three times his current net worth—toward the creation of a medical research center in Kansas City, Mo., to find a cure for cancer. It is no coincidence that he, his wife Virginia, and one of their daughters have all survived cancer. Bernie Marcus first became interested in helping mentally retarded children a decade ago when a Home Depot employee in Atlanta whose child suffered a brain injury had to seek help as far away as Boston. He has spent \$70 million to create an institute in Atlanta to serve children with brain disorders—even recruiting a top scientist away from Johns Hopkins University to head the center.

In each case, these big-money philanthropists are placing bets on key ideas and becoming hands-on in their design and implementation. They have heeded Carnegie's celebrated call to employ in the service of their communities the same smarts and diligence that made them rich. Marcus, for one, hopes to give away the bulk of his fortune before he dies so he can oversee exactly where the money goes and how it is used. Just in case he dies before that, he has videotaped himself talking about his priorities and phi-

MORINO (CENTER) WITH VINCENT PAN AND DARIN MCKEEVER, CO-FOUNDERS OF HEADS UP

losophy of giving, to be shown to future foundation trust who never got to meet him.

By starting his giving early in life, Bill Gates believes he can make a more meaningful difference in eradicating disease in developing countries. If he had waited until his death to use wealth to good purpose, it's likely that tens of thousands of children would have died prematurely because they would have had the benefit of a measles vaccine that costs only 2

"Bill learned enough about the burden of infectious diseases to believe that his dollars are best used now," says Patty Stonesifer, a former Microsoft senior vice-president who is president of the Gates Foundation. "The cost of him being really smart about malaria at 45 vs. 65 was extremely worthwhile. The impact of this money over those 20 years could be great."

Gates is giving away about \$1.2 billion a year through the foundation but is open to spending far beyond that sum annually. His major concern is effectiveness. "It's harder philanthropy to know you did the right thing," says Stonesifer. "The reason there are big social inequities is because they come from deep, complex, historical pressures. There is no quick fix to these problems. Long-term solutions require thoughtful, committed programs to work." It is that and not an objection to distributing more that determines how much the foundation gives away, she says. "Bill would be excited if we brought him another billion-dollar idea or even a \$5 billion idea."

Many other new philanthropists are finding that giving money away can be tough. Eli Broad started two successful companies: insurer SunAmerica Inc. and homebuilder Kaufman & Broad Home, now KB Home. Yet "I'm working harder at this than when I was CEO of SunAmerica," he says.

Broad's first \$1 million gift was made 22 years ago to help build the first contemporary art museum in Los Angeles. Since then, he has given or pledged more than \$1 billion through four separate foundations. But most of his energies these days—and \$400 million of his money—are focused on helping to re-





1947 Auto magnate Henry Ford dies and leaves the bulk of his fortune to the Ford Foundation. More than a half-century later, the foundation still ranks among the top three in size and second in its annual giving. Last year alone, the Ford Foundation gave away nearly \$830 million.

form public education in the U.S. Broad is taking an unusual approach: He's working to develop better educational leaders and creating

annual competition among urban school districts to improve the performance of their students. The winning district was given \$500,000 in scholarship money for college-bound graduates. Broad gave the first prize to a school district in Houston last year. "Now, they can become missionaries to share their best practices with other school districts," he says.

As an entrepreneur, Broad believes that only better leadership will solve the nation's educational crisis. So he also has launched centers to train urban school superintendents and school-board members. The year-long program for superintendents teaches them everything from labor relations to effective leadership, providing role models and lessons from successful school districts. More important, Broad believes, the center has attracted a large amount of nontraditional talent, from retired army generals to businessmen, who have

proven leadership ability and want to apply it to education.

To Broad, giving back is a modest expression of his appreciation for his good fortune. "I know where I came from," says the liberal Democrat, whose father emigrated to the U.S. from Lithuania and was a housepainter and small merchant in Detroit. "I had the wrong religion, the wrong politics, and the wrong family background. But you're accepted in this country if you have a lot of good ideas and energy. I just don't want to sit here with my money and maintain the status quo."

John Alm was drawn to the challenge of helping disadvantaged children in inner-city public schools. He has spent \$7 million in recent years to create a novel program for disadvantaged middle-school children in Los Angeles. Each year, he and his wife Carolyn bring 72 children who have just graduated from eighth grade to Camp Paintrock in the mountains of Hyattville, Wyo. The goal: to prevent them from being among the 38% of ninth-graders in inner-city L.A. schools who eventually drop out. "I'm hoping I can take these at-risk kids and show them a different lifestyle and potential, work with them through high school, help them get into college, to plant them into society as adults who can make a difference," says Alm.

JAMES AND VIRGINIA STOWERS ARE BOTH CANCER SURVIVORS, AS IS ONE OF THEIR DAUGHTERS

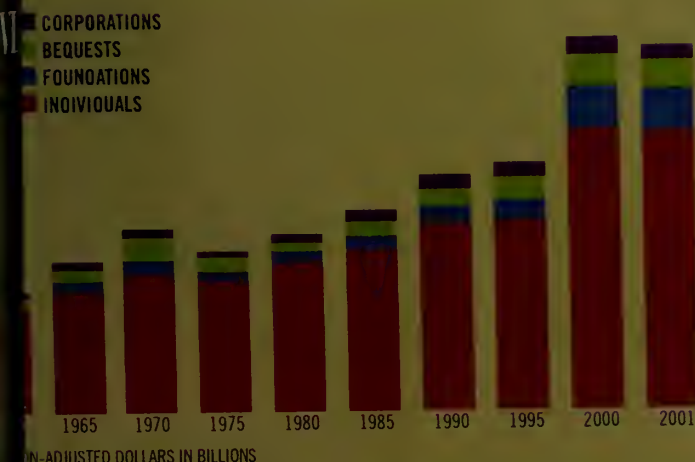
This is fully engaged, high-involvement philanthropy. Alm created his own foundation, built the camp from scratch, designed the program, and hired three

staffers to run it. His wife interviews many of the students chosen by teachers and school counselors. Alm uses vacations and weekends off to work with the children during the summer, while his wife is involved in each of the two five-week camp stays. "The rewards I get from this are unbelievable," he says. "Maybe I could have written a check to an organization and it could do better, but Carol and I wanted to be involved. Maybe it's selfish, but we wanted to see it and feel it."

Not that this new approach hasn't suffered some growing pains. The recent boom-to-bust cycle has been particularly humbling, causing many prominent donors to cut back or postpone their contributions. The Turner Foundation, which recently went through a round of layoffs, is refusing any new funding requests in 2003 and will consider new grants in the following year only by invitation. And some benefactors have fallen behind in making good on their pledges. The Metropol-



WHO GIVES WHAT...



...AND WHERE THE MONEY GOES



Data: Center on Philanthropy at Indiana University



1997 Ted Turner, founder of Cable News Network, pledges \$1 billion, one-third of his entire net worth, to create a foundation to support U.N.-related causes. He chastises the wealthy, urging more of them to ante up for good works, ushering in a new era in philanthropy.

several grants because of the downturn in tech stocks.

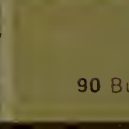
Other new philanthropists have gone off course by assuming they had nothing to learn from those who went before. Some were overzealous in pursuing a venture-capital model in their giving—doling out seed money to social entrepreneurs and insisting on an unrealistic “social return on investment.” The difficulty of achieving change in such intractable issues as drug rehabilitation or economic inequality has led to a sober-

ing reassessment by many newcomers. “The trouble is a lot of new people came into this cocky. We thought we had the answers and wanted to do it ourselves,” concedes Morino. He has since pledged or given away some \$25 million to organizations such as Washington (D.C.)-based Heads Up. “We should have been more respectful of the people who have done this all their lives.”

Then there’s the issue of what gets funded. Philanthropists get substantial tax write-offs when they contribute to the causes as a way to encourage them to return some of their wealth to the community. The community, however, has to say over what they fund, even though the favorable treatment is, in effect, a partial subsidy from the public. Recently, for example, Ruth Lilly, an Eli Lilly & Co. heiress, pledged at least \$100 million to *Poetry*, a small, financially strapped literary magazine. While that may be a good cause,

Cover Story

MOST INNOVATIVE NEW PHILANTHROPISTS

NAME	BACKGROUND	NOTES
 PAUL BRAINERD	Aldus president	Founder of Social Venture Partners, one of the new-wave consortia that lend advice and connections—along with money—to nonprofits in the social-issues arena.
 ELI BROAD	Founder SunAmerica, Kaufman & Broad	Using wealth in a strategic way to reform public education by developing better leadership and creating competition among inner-city schools for scholarship prize money.
 BILL DRAYTON	Ex-McKinsey consultant	Pioneer in funding innovative ideas that leverage small cash donations into big improvements in health, education, and housing through the Ashoka Fund.
 BILL GATES	Microsoft co-founder	Most important philanthropist since John D. Rockefeller Sr., with highly targeted strategic giving in vaccines, library technology, and minority scholarships.
 PAUL TUDOR JONES	Investment banker	Founder of New York’s Robin Hood Foundation, which supports antipoverty programs, collects credit-card contributions via the VISA Foundation.
 PATRICK MCGOVERN	IDG founder	Rewrote the rules for a donor’s involvement in a university gift by exerting a big influence in how Massachusetts Institute of Technology spends his \$350 million to create an Institute for Biotechnology Research.
MARIO MORINO	Software entrepreneur	Acting as a fully engaged venture capitalist for nonprofits that help inner-city children in the Washington (D.C.) area. Thoughtful leader of the New Philanthropy.
CATHERINE MUTHER	Ex-Cisco Systems marketing vice-president	Launched California-based incubators for women entrepreneurs, nonprofit startups, and private foundations.
JEFF SKOLL	Ex-eBay president	Created a community foundation to fund already-successful nonprofit leaders as they expand the scale and scope of their operations.
JAMES STOWERS	American Century mutual-fund founder	Defied critics in successfully building and staffing a first-rate biomedical institute in his hometown of Kansas City, Mo.
LAWRENCE STUPSKI	Ex-Charles Schwab president	Working to reform public-school districts in California and Washington State. Hired ex-NYC Schools Chancellor Rudy Crew to oversee “large-scale systems improvement.”

Data: BusinessWeek



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1999 With his wife, Melinda, Microsoft co-founder Bill Gates donates nearly \$17 billion to create a new philanthropic organization that immediately becomes the nation's largest private foundation. Its first big bet is a \$750 million pledge to the Global Fund for Children's Vaccines.

many could legitimately question whether it was the best use of \$100 million.

Donors, meanwhile, face problems of efficiency and

scale that the corporate world has long since overcome. If philanthropy were an industry, it would be a highly fragmented, remarkably inefficient array of enterprises. On the giving side, tens of millions of donors and foundations give a total of more than \$212 billion a year to charitable causes. "There's a lot of money just sloshing around out there," says Melissa A.

Berman, CEO of Rockefeller Philanthropy Advisors, which assists wealthy individ-

uals in developing and managing their charitable giving. "Half of all the giving is not used optimally." And most foundations dole out only the required minimum of 5% of their assets annually, preferring to perpetuate their own organizations rather than put more muscle behind their stated cause.

On the receiving side are some 700,000 public charities, 40% of them with annual budgets of less than \$100,000. Generally, they are vastly undercapitalized, understaffed, and poorly managed. Most nonprofits use their limited resources to market themselves to the same donors and foundations year after year. There's little if any investment in organizational infrastructure or staff development. "Compared to the for-profit sector, the nonprofit world is back in the late 1970s and early 1980s, when Japan was beating up American businesses," says Jeffrey L. Bradach, managing partner at Bridgespan Group

Advisors Inc., a consultant to nonprofits and philanthropic. "It's only beginning to understand that if you want good comes, you have to invest in building strong organizations.

Many of the new philanthropists are trying to bring badly needed discipline and organization to the field, helping more effectively match up the growing philanthropic capital with the most urgent social needs. That has led to another critical difference in the new philanthropy: active partnership among long-established private foundations, corporate foundations, and individual donors.

Befitting this new spirit of collaboration, Acumen Fund Inc., a leading-edge philanthropic nonprofit, recently gathered 30 of its 39 "investors" for the first of what is expected to be equivalent of an annual shareholders' meeting at, appropriately enough, Pocantico Conference Center, a piece of the Rockefeller Estate in Tarrytown, N.Y. The group, which focuses on global social philanthropy, was created last year with seed funding from the Rockefeller and Cisco Foundations. Since then, W.K. Kellogg Foundation, AOL Time Warner Foundation, and 36 individual philanthropists have expanded up from \$50,000 to \$500,000 apiece as founding partners. "We're learning how to bring to the same table philanthropists, corporations, the big foundations, and the government," says Acumen Fund founder Jacqueline Novogratz, who had led workshops for new philanthropists at the Rockefeller Foundation. "You're going to get better results."

Like many in this wave, Acumen is trying to redefine the rules of giving. Some causes will get loans or even equity-based investment instead of grants, plus management advice and connections. The fund then works with the enterprise to

Cover Story

A TALK WITH PATTY STONESIFER

Patty Stonesifer has been president of the Bill & Melinda Gates Foundation since 1997. In an interview with Senior Writer John A. Byrne, she discusses the Gateses' philanthropy.

To what extent did earlier philanthropists influence Bill and Melinda?

Bill is a history buff, and there is no doubt that he looked at change makers and philanthropists before the whole ramp-up in giving. [Andrew] Carnegie and [John D.] Rockefeller were engaged at the center of society. They identified gaps where they thought their resources could cause a major change. That is the big takeaway that Bill and Melinda had: They wanted to find the place where the opportunity is great to reduce society's burden.

So far, most of your major initiatives have been done in partnership with existing organizations. Why not do more things on your own?



There are many organizations out there that have the expertise [and] the passion and are closer to the problem. If we have a vision of an inequity we'd like to address, then finding people who are close to the problem and have credibility is what we want to do.

STONESIFER: THE GATESES STUDIED GREAT PHILANTHROPISTS—BUT ARE MORE HANDS-ON

What are you doing to measure the impact of the dollars you give?

Proof is real important to us. Our library program (to put the

nology in U.S. libraries) started in 1997, and we have specific data on usage in many states. We use a third-party evaluator, and we have changed some of our programs because of it. Business leaders are not folks who want to waste dollars. In philanthropy, the big fear is whether the dollars are being effectively spent.

How actively engaged are Bill and Melinda?

They spend a tremendous amount of time on the strategic decisions: what models we should use, what interventions and what partners to choose. And they approve every grant over \$1 million in health. Bill Sr. and I have authority for everything under \$1 million. Anything outside our funding strategy would go to Bill, even if it's \$10,000.



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MOVING BUSINESS FORWARD



THE FUTURE?

When investor Warren Buffett, 72, passes away, his vast \$36 billion fortune will go to his family charity, instantly creating one of the biggest endowments in foundation history. One problem: Little infrastructure yet exists to disburse the funds.

budget so we have a real voice," adds Novogratz. "That way, it ties you closer to the success or failure of the organization."

More than a new approach or method of giving, however, the new donors are underwriting a remarkable era of creativity and innovation. Many of them are corporate or entrepreneurial dropouts who wanted to work in the nonprofit sector.

Cover Story

she was 46. With her high-tech marketing experience, Stanford University MBA, and \$2 million from Cisco stock options, she started her own private foundation, calling it Three Guineas Fund after the 1938 book by Virginia Woolf. The book takes the form of three letters, each a reply to the request for a guinea: one to prevent war and preserve intellectual liberty; one to educate women; and one to promote their employment.

velop a business plan and structure the financing—and holds it accountable to agreed-upon milestones. "We like to give 20% of their
Catherine Muther quit her job as marketing vice-president at Cisco Systems in 1994, when

Woolf exacts a price for her donations: She insists that each fund-raiser hear her out on how the money can best be used. Muther first created a San Francisco incubator to support high-tech startups by women entrepreneurs and has since taken the incubator concept a step further—recently launching one to help nonprofit startups, including Silicon Valley-based Girls For A Change.

Like Gates and Turner, Broad and Stowers, Muther is one of many people helping to redefine philanthropy. And they are heeding the most important message that Andrew Carnegie delivered more than a century ago: "The day is not far distant when the man who dies leaving behind him millions of available wealth will pass away unwept, unhonored and unsung. The man who dies thus rich dies disgraced."

With Julia Cosgrove, Brian Hindo, and Adam Day in New York

BusinessWeek online

For Q&As with leading philanthropists Patty Stonesifer, Eli Broad, and Wal-Mart heir John Walton, go to the Dec. 2 issue online at www.businessweek.com.

QUIET GIVERS, CHAPSKATES OR WHAT?

Many billionaires give a lot of money, but it may be a relatively tiny percentage of their net worth. Some say their charitable giving is anonymous and it doesn't show up in public records. Others say they plan generous donations when they die. Still others have different reasons for retaining the great bulk of their wealth. Here is a sampling:

NO.	NAME	BACKGROUND	RESPONSE & NOTES	ESTIMATED TOTAL GIVING* MILLIONS	CURRENT WEALTH NET WORTH** BILLIONS	W DO
 ELLISON	1. LARRY ELLISON	Oracle founder	Says results count more than amount given	\$69	\$15.2	
	2. BARBARA COX ANTHONY	Media empire heiress	Adds just \$500,000 annually to her own foundation	40	9.5	
	3. MARS FAMILY	Candy fortune	"Their wish is for these matters to remain private"	150	30.0	
 REDSTONE	4. SUMNER REDSTONE	Viacom founder	Says donations are anonymous	45	9.0	
	5. STEVEN BALLMER	Microsoft CEO	Makes most donations privately	38	11.9	
 BUFFETT	6. WARREN BUFFETT	Berkshire CEO	Plans to bequeath wealth to his foundation	230	36.0	
	7. RUPERT MURDOCH	News Corp. chairman	"The family does not make public how much is given"	40	5.0	
 WALTON	8. WALTON FAMILY	Wal-Mart Heirs	Wants to keep 38% stake in company founded by father	1,000	94.0	
	9. TY WARNER	Beanie Babies founder	Gives mostly from his company's coffers	65	6.0	
ICAHN	10. CARL ICAHN	Financier	Gives some for charter-school reform and children	65	5.8	

*Based on public records and interviews with donors

**Based on Forbes 400 list and BW estimates

†Donations as a percent of current net worth



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DDC/CI	No	No	Yes	Yes	Yes	Yes	Yes
No Touch Auto Adjust	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Integration Capable	Yes	Yes	No	Yes	Yes	No	Yes
LiquidView™ Software	No	No	No	Yes	Yes	Yes	No
Multimedia	No	No	Yes	No	No	Yes	No
Vacation Switch	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Cable Management	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Input Interface Connectors	VGA	DVI-D & VGA	DVI-D & VGA	VGA	DVI-D & VGA	DVI-D & VGA	DVI-D & VGA

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PENSIONS

WHERE'S MY PENSION?

Company pension plans are vastly underfunded. The cures range from cash infusions to cuts in benefits

The slow-moving storm battering traditional pension plans is hitting Old Economy companies full force, making them less competitive, driving up expenses, and sucking cash that might otherwise go toward capital investment and pumping up the economy. There's no safe harbor because their assets, mostly invested in stocks, have plunged 19% since the start of 2000 while their projected obligations have surged 49%, according to research shop Ryan Labs Inc. The result: By yearend the so-called defined-benefit plans of Standard & Poor's 500-stock index companies will be underfunded by \$243 billion, estimates David Zion, accounting analyst at Credit Suisse First Boston.

The problems are concentrated in old-line industrial companies that are still burdened by labor contracts made years ago. Their promises put them at a big disadvantage with foreign companies and domestic upstarts that don't have such baggage. Worst hit among major companies are those in the auto, auto components, airline, oil and gas, and pharmaceutical industries. General Motors, Ford, Delta, AMR, Goodyear, Navistar, and Cummins, for example, could each end the year with plans underfunded by more than half of their stock market value.

There's no painless cure. On Nov. 18, Delta Air Lines said it will convert its main defined-benefit plan to a cheaper cash-balance plan, that usually transfers market risk to retirees. Caterpillar

Inc. is cutting both retiree health benefits and future pension entitlements of workers hired after Jan. 1, 2003. Other companies are slashing capital spending, issuing stock, or selling off businesses to replenish their funds. "We're talking to clients who are deciding what businesses to sell, what to close down, what capital expenditures

not to make and what people not hire in order to be able to make cash contributions to their pension plans," says Kevin C. Wagner, retirement practice director at consultant Watson Wyatt Worldwide.

Naturally, companies are trying to put the best possible face on their situation, arguing that their problems w



THE PENSION PAIN

Companies are under the gun to make up for losses in defined-benefit plans

Data: Company reports

CATERPILLAR

Problem: Estimated pension underfunding soared 180%, to **\$2.8 billion** in the third quarter.

Response: Imposing spartan pension plan on hires after Jan. 1, 2003; cutting other retiree benefits.

GENERAL MOTORS

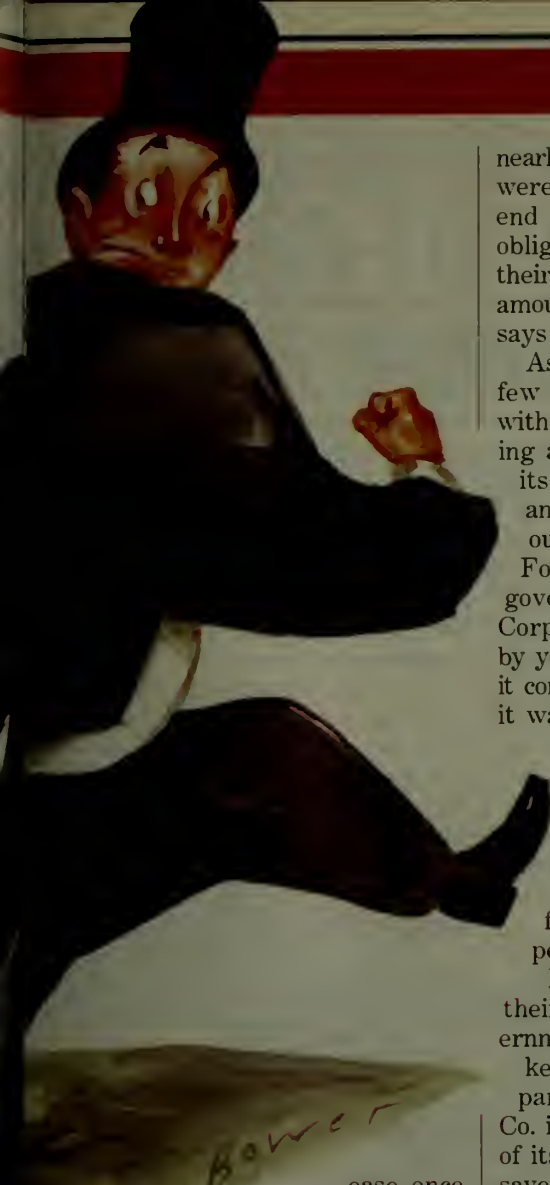
Problem: Plan could be **\$23 billion** underfunded by yearend; plan earnings could take another \$1 billion from 2003 earnings.

Response: Considering \$2 billion contribution next year.

HONEYWELL

Problem: Fund assets plunged **\$1.6 billion** year. Result: an estimated \$285 million expense pretax income next year.

Response: Considering million contribution, n in stock.



nearly 360 S&P 500 companies with plans were overfunded. Now, 91% will likely end the year with shortfalls—and an obligation to contribute \$29 billion to their plans next year, nearly double the amount they had to pony up in 2001, says CSFB's Zion.

As they ponder how to fill the void, a few companies are prepared to part with cash. Whirlpool Corp. is considering a \$200 million cash contribution to its plans at yearend, largely to avoid an accounting charge that could wipe out 20% of its shareholder's equity. For others, it isn't an option. Under government rules, Northwest Airlines Corp. faces a \$223 million contribution by yearend. It is asking regulators to let it contribute stock of a commuter airline it wants to take public—and an extra five years to shore up its plans. "We've seen a lot of interest in funding waivers," says Watson Wyatt's Wagner. But the government is leery of granting waivers because its Pension Benefit Guaranty Corp. insures many pension benefits.

Most companies would rather fund their plans with their own stock. Government rules generally allow plans to keep 10% of their portfolios in company assets. Bearing maker Timken Co. is issuing 3 million shares, nearly 5% of its outstanding stock, to its plans, to save cash and pay down other debt. IBM is considering putting \$1.5 billion of stock, about 1% of its outstanding shares, into its plans.

Although issuing stock saves cash, it is no free lunch. When truck builder Navistar International Corp. put 7.75 million shares of company stock into its plans on Nov. 8, it diluted its shareholders by 13%. To Navistar, that was the lesser evil. "As long as we can make the contributions with stock, we still have the money to do capital investments that we'd like," says Chief Financial Officer Robert C. Lannert. What's more, by issuing stock the company increases the equity on its balance sheet, making it look better to credit-rating services, he says. But the

shares filled only half of a \$350 million hole in Navistar's plans. And since the plans now have 8% of assets invested in company stock, Navistar won't be able to add much more without special permission from regulators.

The pension burdens worry Wall Street. Companies with traditional plans are having to pay more for capital because investors and credit-rating services are leery about their obligations and the Byzantine accounting and funding rules governing them. Navistar now has three retirees for each active worker. And both LTV Corp. and Bethlehem Steel Corp. have gone bankrupt under the weight of retiree benefits that competitors don't have. "You're going to see a lot more bankruptcies over this issue," says workout investor Wilbur Ross, chairman of W.L. Ross & Co.

The complex accounting and funding rules make matters worse. Many investors now distrust pension accounting because it distorts reported earnings. And, occasionally, some companies find themselves in a bizarre Catch 22—because their plans are underfunded according to generally accepted accounting principles but overfunded according to government rules. If they pump money into their plans, they risk a 10% excise tax and loss of the tax deduction on their contributions, says John Ehrhardt, consulting actuary at Milliman USA.

Such government rules discourage companies from putting more money into their plans during the good times. As a result, the underfunding situation is worse than it might have been. "The rules are not conducive to an orderly pattern of contributions over the years," says Larry Sher, principal at Buck Consultants Inc.

But the prospects for fixing them are slim. The more likely outcome is that companies with defined-benefit plans will phase them out in favor of schemes that put risk on the shoulders of workers—the very people who already feel most vulnerable.

By David Henry in New York and Michael Arndt in Chicago with David Welch in Detroit

ease once the stock market picks up. After S&P downgraded Ford Motor Co. on Oct. 25, partly over pension issues, treasurer Malcolm S. Macdonald held a conference call on Nov. 14 to reassure worried analysts and investors that the problems will abate. "It is neither necessary, nor, frankly, advisable to overreact to recent volatility in equity markets," Macdonald said. In fact, the plans got some help in October when stocks and bonds moved sharply in their favor.

But it will take more than a few months of good markets to undo problems that have built up over three years. At the end of 1999, 76% of the

IBM

Problem: Expects \$700 million reduction in pretax income from lower returns on investments. Needs to contribute **\$1.5 billion** annually to plan.

Response: May contribute \$1 billion of company stock to plan.

NORTHWEST AIRLINES

Problem: Owes \$223 million to plans and could owe an additional **\$400 million** next year.

Response: Asking IRS for more time to pay and Labor Dept. for permission to contribute shares of a planned spin-off.

SBC COMMUNICATIONS

Problem: Costs for pension and other retiree plans expected to rise **\$1 billion to \$2 billion**, 20¢ to 40¢ a share, next year.

Response: Raising retiree co-payments for medical and dental services.

WHIRLPOOL

Problem: Plan may tip from \$143 million overfunded to being underfunded, triggering a **\$200 million** noncash charge.

Response: Considering \$200 million cash contribution at yearend to avoid the charge.

THE POPULIST ON THE BANKING COMMITTEE

Why the GOP's Richard Shelby has the finance lobby fretting

He's a politician who is passionate about privacy issues and is a tiger when it comes to investors' legal rights: He believes investors should be able to sue accountants and law firms that help corporations commit fraud. And he would bar big banks from expanding into real estate brokerage. If this sounds like your typical liberal Democrat, guess again: It's a Dixie Republican named Richard C. Shelby, Alabama's senior senator and the incoming Senate Banking Committee chairman.

Normally, the business community would be breaking out the Dom Perignon over the return of the banking panel to Republican rule. But since the GOP sweep in the Nov. 5 elections, financial industry lobbyists have been wringing their hands. Over the years, Shelby has been an unpredictable ally whose views sometimes put him at odds with Corporate America. He is a conservative Republican who backs a flat tax, pushes for regulatory relief, and favors curbs on immigration. But he also worries that some banks have accumulated too much market power, gripes that Wall Street firms are getting a free ride on deposit insurance, and would make defendants in securities fraud lawsuits liable for all damages, even if they played a minor role. In short, he's more Main Street than Wall Street.

In substance and style, Shelby, 68, will be a departure from the committee's previous GOP chairman, Texas Senator Phil Gramm. Both are conservative Democrats-turned-Republicans. But while Gramm has a doctrinaire, free-market's disdain for regulation, "Shelby comes from the populist strain of the Republican Party that has an equal distrust of big government and big business," says James L. Pitts, executive director of the Financial Services Coordinating Council, an umbrella group of financial trade associations.

Unlike Gramm, the courtly Shelby is

tough to pigeonhole. He joins with liberal and consumer groups on privacy. He's leery of overconsolidation and plans hearings to explore whether banks are tying the availability or pricing of credit to investment banking services. "I do not believe that it is good for America for four or five institutions to run the whole country," he says. "It crowds out competition." But Shelby opposes efforts to expand the percentage of loans banks must set aside for low-income housing. And he has largely been silent while other Republicans have pushed

MAIN STREET AGENDA

The new Senate Banking Committee Chairman's background is studded with populist moves. He supports:

▶ **Forcing financial firms** to get customers' agreement before sharing their personal data with affiliates or outsiders

▶ **Blocking banks** and financial holding companies from expanding into real estate brokerage

▶ **Restoring investors' right** to sue law firms and accountants for aiding and abetting securities fraud

▶ **Probing** whether lawmakers went too far in lifting Depression-era barriers between commercial and investment banking

to tighten government regulation of mortgage-financing behemoths Fannie Mae and Freddie Mac. "People who expect someone who fits easily into an ideological box will be scratching their head," says ex-New York Republican Representative Rick Lazio, now head of a financial services CEO group.

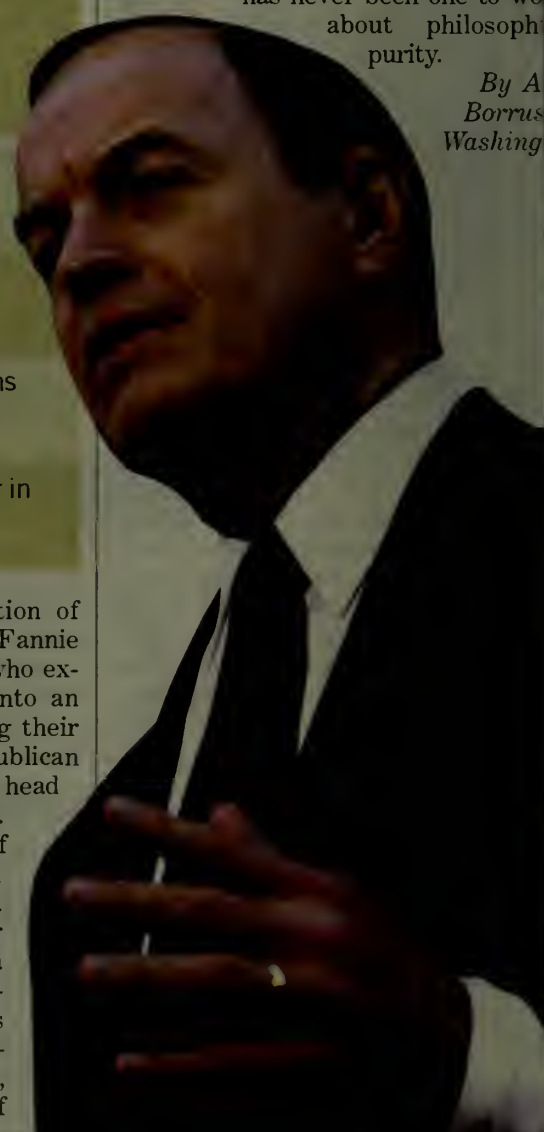
Being a thorn in the side of powerful interests doesn't seem to bother Shelby, an Alabama steelworker's son who served four House terms before winning a Senate seat in 1986. A former trial lawyer and prosecutor, he hails from a state that has no big financial institutions. What's more, Alabama is among a handful of

Southern states friendly to product liability lawsuits that are the bane of corporations. "You shouldn't be scared of the American system of jurisprudence," Shelby insists. Attorneys like that lot of talk, and over the past five years lawyers and law firms gave \$538,036, far exceeding the \$485,209 received from securities firms, insurance companies, and commercial banks combined.

Shelby is not tipping his hand on what he'll do as banking chairman. He is likely to renew his quest to force banks to give customers more control over how their personal data are used. "It is going to be a huge fight," says Ed Yingling, chief lobbyist for the American Bankers Assn. Those who know him say he strives for consensus. "Richard Shelby used to being in the courtroom, where you sometimes negotiate a settlement that may not be exactly pure but is the right thing to do for your client," says Senator Robert F. Bennett (R-Utah), soon to be the banking committee's second-ranking Republican. But Shelby

has never been one to waffle about philosophical purity.

By A. Borrus
Washington



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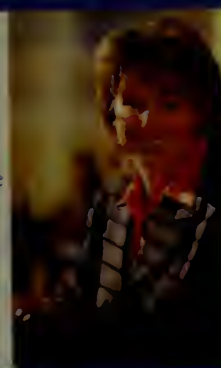
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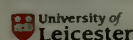
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ATTACK OF THE KILLER DUST

Relax, it's a novel. Still, nanotech has a scary side

Prey is a nightmare scenario: A group of brash Silicon Valley scientist-entrepreneurs, racing against a deadline and desperate to strike it rich, field-test a swarm of micro-robots the size of dust particles in the lonely desert around their Nevada factory. Designed under a military grant, the 'bots are supposed to be the latest in battlefield surveillance. But they quickly morph into predatory, self-replicating swarms. Actually, the swarms issue from the keyboard of author Michael Crichton, creator of *Jurassic Park* and other tales of science-run-amok. Slated for release on Nov. 25, the latest novel, *Prey*, taps into society's fear of scientists too enthralled by their creations to fret about the consequences. And, as in his previous works, Crichton has made a shrewd choice in *Prey*: He mines the budding field of nanotechnology—the science of the extremely small. “We’re in a social environment that’s tremendously disoriented by new things,” Crichton said in an interview. “But there always is a downside.”

The timing of Crichton's novel is both good and bad. It arrives at a juncture when prominent scientists are debating the potential hazards of nanotech research. Yet the plot pales beside the real specter of biowarfare in the post-September 11 world. Compared with the known horrors of a smallpox epidemic, Crichton's sentient, micromechanical swarms feel like the far future—which means real scientists may find the author's treatment ludicrous. At timing aside, the book could serve an important function, prompting the public to contemplate the potential hazards of this new field. “These technologies have risks,” acknowledges Neil Gershenfeld, director of the Center for Bits and Atoms at Massachusetts Institute of Technology. “There is great value in keeping stock of them.”

How implausible is Crichton's latest scare story? Briefed on the plot by *BusinessWeek* several weeks before *Prey* went on sale, scientists on nanotech's frontier were mostly dubious. But serious researchers have been kicking around scenarios that resemble Crichton's for years. The latest round of hand-wringing commenced when Sun Microsystems Inc. co-founder Bill Joy published an essay on the topic in *Wired* magazine in April, 2000. In his piece, the renowned software engineer warned that the convergence of nanotech, genetic engineering, and robotics could trigger unprecedented disasters.

Some scientists ridiculed Joy's thesis at the time—but Joy has not backed down. If anything, his views have hardened into a stance that radically challenges how science is now practiced. “We have to limit access to the kinds of scientific information that lets people do these kinds

of things in laboratories,” Joy declared in a TV interview in October. “That will require regulation of materials and information in ways that we haven't had to do before” (page 104).

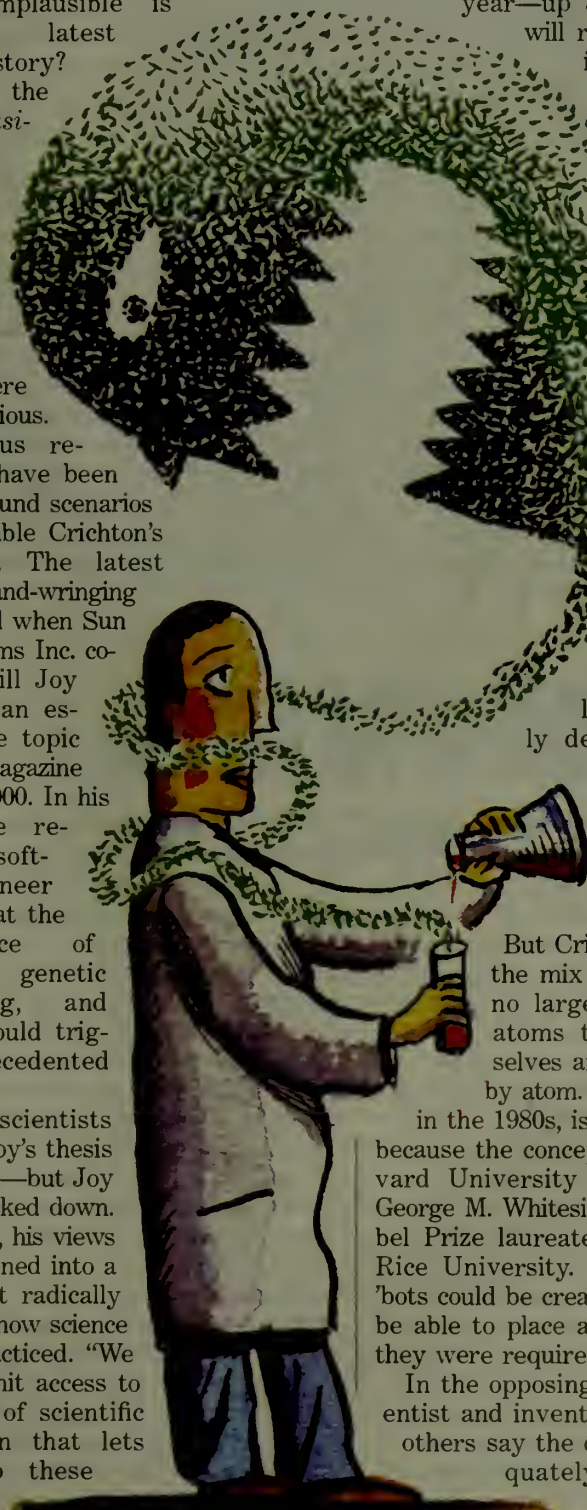
Threatening or not, nanotech is fast emerging as a fruitful confluence of science and engineering. Once considered blue-sky research, the field has produced such milestones as carbon nanotubes a few hundred millionths of an inch thick that function as the world's tiniest transistors. The U.S. government is pumping \$604 million into nanotech research this

year—up 30% from 2001—and will raise the ante by 18% in 2003. Biologists, chemists, software engineers, and venture capitalists are flocking to nanotech seminars. Over the past year, venture funds have committed about \$437 million to 46 nanotech deals, according to Venture Reporter.

Even this outpouring of funds, though, won't take the technology to the level Crichton fancifully depicts. Where fiction and science part ways is on the topic of self-replication. The scientists in *Prey* use cell cultures to breed their nanobots.

But Crichton also throws into the mix “assemblers”—robots no larger than a handful of atoms that construct themselves and other objects atom by atom. The term, popularized in the 1980s, is a red flag to skeptics because the concept is flawed, say Harvard University chemistry professor George M. Whitesides and chemistry Nobel Prize laureate Richard Smalley of Rice University. Even assuming such 'bots could be created, they would never be able to place atoms precisely where they were required, argue both men.

In the opposing camp, computer scientist and inventor Ray Kurzweil and others say the doubters haven't adequately accounted for the role powerful com-



puters will play in solving such problems. Even fringe nanotech concepts could benefit from trends such as Moore's Law, which holds that the computing power of microchips doubles every 18 months. "People say we're not going to see self-replicating nanotechnology entities for 100 years," Kurzweil notes. "But we're doubling the paradigm shift for every decade, so we'll get there in 25 calendar years."

Of all the diverse nanotech projects under way, the ones that most closely evoke Crichton's drama are lab experiments on "smart dust." Kristofer Pister, a professor and director of the University of California at Berkeley's Sensor & Actuator Center, is working on such de-

THE SCIENCE IN MICHAEL CRICHTON'S PREY

There is some real science in Michael Crichton's tale of a nanotech run amok—along with pure fantasy. Here are a few plot points where fact and fantasy diverge:

	SELF-REPLICATING MICROMACHINES	MOBILE SWARMS	EMERGENT BEHAVIOR
FICTION	In <i>Prey</i> , malevolent micro-robots replicate and thwart scientists' efforts to exterminate them.	Crichton's swarms move through the air, relying on built-in solar cells with several hours of storage capacity.	The predatory swarms in <i>Prey</i> exhibit intelligence far exceeding the abilities of the individual micro-robots.
FACT	Nanotech researchers are creating new materials and devices with unique chemical properties and functions. The goal is to have the devices assemble themselves—but that's decades in the future.	Scientists are developing sensor-laden "smart dust," which could be used, say, to sniff out biological or chemical weapons. Such sensors might be solar-powered and wind-borne, but self-navigation is a stretch.	Bees construct hives and defend them in ways that surpass the genetic programming of individual bees. Such "emergent behavior" could appear in swarms of smart machines—but probably not for 50 years.

vices, which are now about the size of sand grains and contain sensors. His ultimate goal is to create dust-size particles fitted with silicon intelligence, radios, sensors, and possibly wings. Such grains could be scattered through buildings—or over a battlefield—to monitor the environment and

scare scenarios play a useful role. Under the public's watchful eye, researchers more likely to proceed with caution and continue to develop technologies will help protect us from ourselves.

By Heather Green in New York

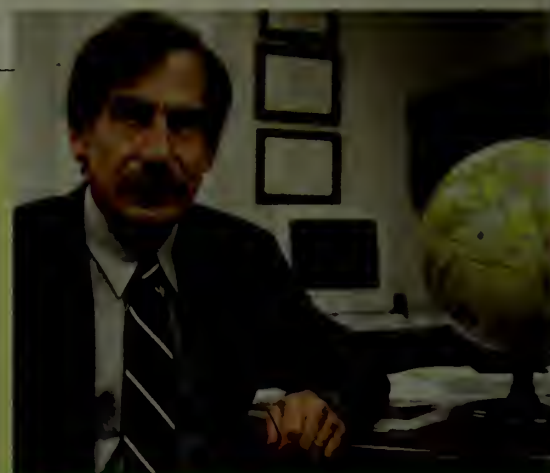
BIOTECH: CAN WE KEEP THE GENIE IN THE BOTTLE?

Michael Crichton's vision of a nanotech calamity won't frighten many scientists who work in this young and underdeveloped field. But by mixing genetic engineering into his brew, Crichton hits a nerve. Refined anthrax spores have already been used as weapons. Terrorist groups may well have access to smallpox. And with today's biotech tools, they could reengineer these and other microbes, unleashing pests that kill in unexpected ways and are resistant to most drugs.

The threat of novel bioweapons has prompted a painful debate among American scientists: Should researchers censor themselves to stanch the flow of potentially dangerous information? The answer is probably yes, but there are at least three challenges. The pathogens—other than smallpox—are found everywhere in

nature. Biotech expertise is also widely distributed around the globe, so self-censorship in one country may not prevent terrorists from obtaining knowledge and materials elsewhere. And there is a cost if scientists stop pooling their discoveries about killer pathogens. "By understanding what makes them deadly, we can protect people. That's what biomedicine is all about," says Ronald M. Atlas, co-director of the Center for the Deterrence of Biowarfare & Bioterrorism at the University of Louisville.

There is no easy solution. Still, the research community is taking action. In October, the National Academy of Sciences issued a statement encouraging members to think about what kinds of previously unclassified research should be restricted. Articles



WEIGHING THE RISKS: Louisville's Atlas

submitted for publication by the American Society for Microbiology (ASM) are now reviewed and could be rejected if the information contained poses a threat. In January, the National Academy of Sciences plans to open high-level debate on the whole topic. One proposal: Classify a narrowly defined set of information—throw it, in effect, into a black box. What goes in? "Clearly, a cookbook for bioweapons," says Atlas, who heads the ASM. Beyond that, he acknowledges, it's a slippery slope.

By Heather Green

Developments to Watch

OTIS PORT

Over 5,000 scientists, engineers, and business managers flocked to Baltimore the week of Nov. 18 for an annual update on supercomputing. Sponsored by the Institute of Electrical & Electronics Engineers, the SC2002 expo was brimming with news. Senior Writer Otis Port culled these highlights:

FEEDING THE TRAFFIC GRIDS

ONLY A HANDFUL OF government labs and corporate giants could afford to solve tough problems with supercomputers—or enable researchers to swim in a pool of simulated atoms. But the World Wide Web and high-speed networks are changing that. With so-called grid computing, even personal computers can serve as a virtual supercomputer if enough of them are linked together. Now, Cern—the European Center for Particle Physics, where Tim Berners-Lee conceived the Web—is hatching a

way to accelerate grid computing. Cern researcher Wolfgang Hoshchek said new software will soon scan all the available computers on the Web and find the most efficient combination to solve a particular problem. Divvying up a grid problem among disparate computers will no longer be a major headache.

In a similar effort, Entropia and the San Diego Supercomputer Center described progress on software that will help a grid organize itself, initially for online computational chemistry. And Platform Computing has joined with five Texas universities to improve cooperation among computers—and among various grids. It's dubbed the Grid of Grids.

WHEN THE SIMS MEET THE CELLS

THE MEETING ROOMS AND exhibit booths, advances in biological research sparked excitement. NASA's exhibit featured a simulation of a new artificial heart and a model of blood flowing through the artery, produced with Stanford University. Eventually, the model will enable surgeons to play what-if games when planning cardiovascular operations.

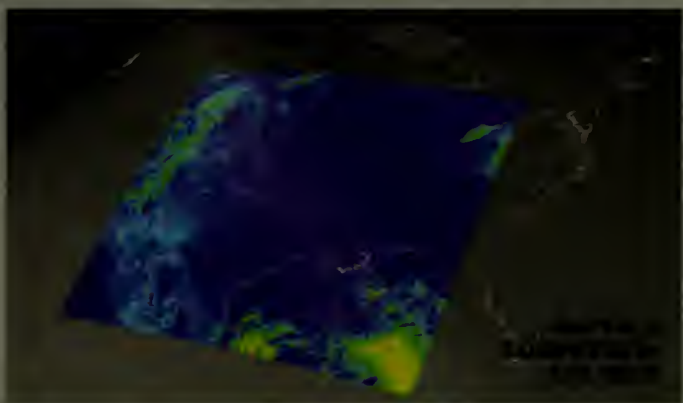


Two papers described new insights into cellular mechanisms. Klaus Schulten, director of theoretical biophysics at the University of Illinois' Urbana-Champaign Institute, told how his team cracked the secret

of aquaporin. This tubelike protein (model below) conducts water into cells, then traps protons, which are essential to a cell's energy supply. Tapping into the Pittsburgh Supercomputing Center, Shulten's group built a model of aquaporin, then watched as water molecules entered, oxygen atom first, pirouetted midway through so hydrogen led the way out, and dropped off a proton in the process. The model may point to new treatments for kidney disease.

Frederick H. Hausheer, CEO of BioNumerik Pharmaceuticals, said simulations are also uncovering hidden mechanics of cancer and drug-DNA interactions. His company has two cancer drugs in clinical studies.

JAPAN: STAYING TOPS IN TERAFLOPS?



EARTH SIMULATOR WAS THE TALK OF THE BALTIMORE show. Built by NEC, it became the new world speed champ last March, rated at a peak speed of 40 trillion calculations per second, or 40 teraflops—three times faster than the mightiest U.S. supercomputer. In a keynote address, Tetsuya Sato, head of the Earth Simulator Center in Yokohama, reported another shocker: On some problems, Earth Simulator sustains an average speed of 75% of its peak speed, compared with perhaps 15% of peak speed for most U.S. supercomputers.

But the U.S. is battling back. Thor's Hammer is a prototype computer at Sandia National Laboratories, developed in partnership with Cray Inc., that uses microprocessors from Advanced Micro Devices. By 2004, a Sandia system called Red Storm with 10,000 AMD chips will match Earth Simulator, and perhaps hit 100 teraflops by 2006. Cray also announced its new Cray X1, which will offer up to 52 teraflops next year. By decade's end, Cray could have a 1,000 teraflops system. That's also the speed target for IBM's Blue Gene/L, slated for 2004.

INNOVATIONS

■ At some SC2002 sessions, talks were immediately converted into text on a computer display on the stage—and with pretty fair accuracy. To show the power of grid computing, voice signals were zipped to Franklin Park, Ill., converted to text by software from Caption First, and bounced straight back. University of Wisconsin researchers helped develop the system, and they're also working on a speech-to-sign language variation.

■ Gilgamesh refers to a new supercomputer chip design developed by California Institute of Technology, University of Vienna, and NASA. To help future supercomputers deal

with hundreds of trillions of instructions every second, the chip combines microprocessor and memory circuits on the same silicon. The Gilgamesh design could be essential for "petaflop" computers that will whip through a quadrillion calculations per second.

■ Researchers at Los Alamos National Laboratory dreamed up a catchy name for their new home-built \$335,000 supercomputer. Green Destiny crams 240 processor chips from Transmeta into a compact box that spits out up to 40 gigaflops, yet sips only 5,200 watts of electricity. On a flops-per-watt basis, that's less than 1% of what many supers gulp, thanks to Transmeta's power-stingy chips.

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INSTRUMENTS FOR PROFESSIONALS

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SEPTEMBER 2, 2002

MAKING LIFE RICHER

A hand is pointing its index finger towards a black VHS tape. Behind the VHS tape, a DVD disc is visible, showing its characteristic rainbow-colored reflection. The background is a solid yellow color.

Save Those Memories

How to Transfer
Videos to DVD **Page 110**

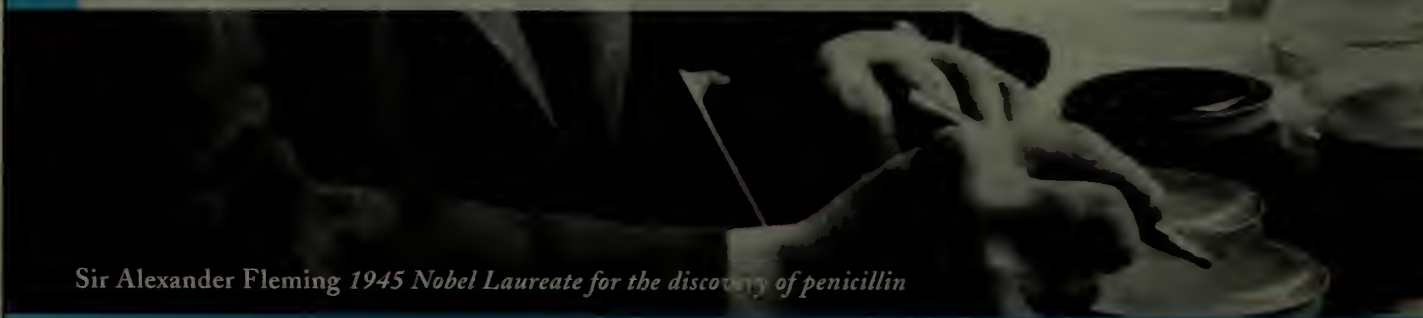
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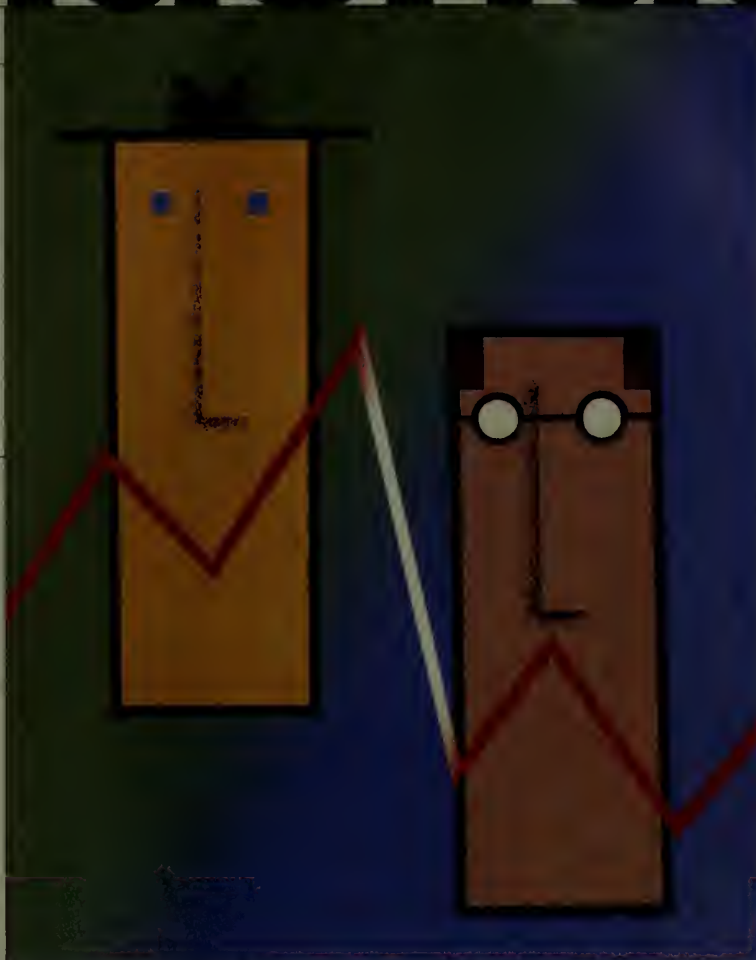
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THE MARKETS

Beware of Noise

STOCK PLUNGES. TRADING VOLUME in the shares soars. CNBC is all over it. You rush to buy in on the cheap. Good move? Probably not, according to economists **Brad Barber** of the University of California at Davis and **Terrance Odean** of the University of California at Berkeley. To see if individual investors operate differently from institutional ones, they studied the trading of stocks that were in the news, that traded on unusually heavy volume, or that had big swings in price. Among their findings: On days of unusually **high trading volumes**, individuals were buying rather than selling by a nearly 2-to-1 margin. By contrast, the pros sold on such days, waiting to buy instead on days when targeted stocks were trading quietly.

That may be an example worth following. Barber and Odean note that the **attention-grabbing stocks** individuals bought underperformed the market—and also trailed the stocks they sold on the same day. They advocate indexing for most investors. But those who prefer individual stocks would be better off patiently scooping up shares on days when stocks are out of the spotlight.

Robert Barker

INVESTING

TIME TO GET BACK IN?

MELLON CAPITAL MANAGEMENT, with \$79 billion in assets, told private clients in September that its number-crunching models were signaling drastic moves: **Invest 100% in stocks.** Why? Earnings and cash flows are better than headlines suggest.

It has given this auspicious advice only four times before:

ALL-EQUITY SIGNAL	S&P GAINS 12 MONTHS LATER
DEC. '74	35.6%
SEPT. '77	12.4%
MAY '80	31.3%
MAR. '86	29.3%

Data: Mellon Capital Management

TRAVEL

FADED MEMORIES

Yet another warning for air travelers: The new, more powerful **baggage-screening** equipment may **damage unexposed and exposed film** stored in checked and carry-on bags. The U.S. Transportation Security Administration says to keep film with you, and request a **hand inspection** at the security checkpoint. Better yet, buy your film after the flight and have it processed—or sent to a mail-order developer—before you return home.



WHEN OUR FIRST daughter was born six years ago, my in-laws gave us a video camera to preserve her first steps, first words, and—alas—even her first temper tantrum. Then about a year ago I started hearing disturbing news about videotapes: They won't

last more than 10 or 15 years, which means my two daughters can watch the tapes when they're in high school or college, but their kids won't likely ever see the footage.

What to do? Since DVD recorders—commonly known as “burners”—have now gotten cheap enough for the mass market (\$300 to \$500), this seemed like a good time to transfer my old analog Hi8 videotapes to disks, which are presumed to last several decades, although no one really knows for sure.

The switch to DVD isn't as straightforward as it should be, but if you're com-

out \$3 to \$8 for each blank disk. This method, however, only transfers your original footage to disk—both good scenes and bad—so your friends will never discover your true talents as a Hollywood filmmaker.

If you want to get in touch with your inner Spielberg, the first hurdle is putting your footage into the computer. In an ideal world, you would plug your camera into your computer and be ready to go. Not so fast. Relatively few PCs have an “analog video capture card,” the little device that can convert an analog signal (which comes out of your camera) into a digital one (the only kind your computer can understand).

There's a relatively simple—if rather expensive—workaround this: Buy a new digital camcorder, which costs about \$600 and up. You can plug the analog camera into the digital one and then hook the digital camera into your PC. The digital camera takes care of the conversion for you, but you still need a fast Firewire connector (a rarity on an older computer) to make this work. Although I found myself tripping over a tangle of wires and cables, once I got the two cameras hooked together, getting the video into my PC was a snap.

The other option is to buy a video capture card. If you're squeamish about opening up your computer's internal one,

ROLL YOUR OWN

Archiving your old home videos on DVD isn't so easy, but you can master it if you're willing to spend several hours at your computer.

There are three basic steps:

1. **CAPTURING** You first must convert your movies into digital format and get them onto your PC. One way is to connect your old camcorder through a new digital one (about \$600). Otherwise, you'll need a special card (\$80-\$250) in your PC to do the conversion.

2. **EDITING** You can edit your videos on a computer, but it's a lot easier to do it on a camcorder. Some camcorders have built-in editing features, but you'll need a special program (about \$50) to do the editing. Otherwise, you'll need a special program (about \$50) to do the editing.

3. **BURNING** You can burn your videos onto a DVD, but it's a lot easier to do it on a DVD burner. Some DVD burners have built-in editing features, but you'll need a special program (about \$50) to do the editing. Otherwise, you'll need a special program (about \$50) to do the editing.

Unfortunately, capturing can be time-consuming, and

Save Those Home

You'll need to spend at least a couple hundred bucks—and a lot of time

ABCs of DVDs

To make DVDs, you'll need a burner.

Hewlett-Packard and Sony make stand-alone models that cost about \$400 to \$500. You can also plug into a fast FireWire port on your PC. Many others sell internal drives for

about \$300, but you need to open up your PC to install them. **Once you have your drive, you'll need DISKS.** Here, you can choose from DVD+r, DVD+rw, DVD-r, and DVD-rw. All four disk varieties will play in most newer DVD players. So just make sure you buy disks that work with your

burner—most of which take either "+" or "-" disks, but not both. **Then decide how you want to use your disks.** The "rw" stands for "**REWRITEABLE**" and means a disk can be recorded over many times, like a videotape. A simple "r" indicates it can be burned only once.

can't take too many short cuts. My first instinct was to throw the gear together, turn it on, and go to bed. When I did this with the Adaptec capture card, though, any interruption in the original video—even a one-second blip static—caused my computer to stop recording even as the analog camera kept rolling. So in the morning, I had to wake up to a 15-minute file on my hard drive and my analog tape all the way at the end. This wasn't a problem when I used a digital camera. Adaptec says it's fixing the problem. When I finally burned my raw

2. EDITING
Remember all that great footage you have of the inside of your backpack? Editing software (\$50 to \$100) lets you cut those scenes out, then add titles, transitions between scenes, and menus that help viewers navigate your video.

footage on my PC's hard drive, it was time to get creative. Or so I thought. It took several hours of fiddling with various programs before I understood the ins and outs of video editing. The program I found simplest to use was Sony's EZ Video. I was able to drag the clips I wanted onto an editing bar and cut out some of the clumsier camerawork, such as footage of the concrete and cobblestone sidewalks of various European capitals. Then I chose from dozens of fonts for titles and from a variety of options for transitions between scenes. You can

choose cinematic effects such as pages turning or images spinning into the frame like newspapers in a 1940s movie. Finally, I added a menu, so I could jump to my daughter's first steps without fast-forwarding through her less auspicious early moments. I also tried Roxio's VideoWave and Sonic Solutions' MyDVD, both of which were more than adequate, if somewhat more complicated to figure out.

Once I had my finished movie, it was time to burn it on a DVD.

The first step here is rendering—that is, creating the actual file that

3. BURNING
When you finally create your masterpiece, you'll want to record it onto a DVD so you can show it off. Most editing packages also let you record—or "burn"—disks with a couple of clicks.

will be recorded. This is painfully slow: A two-hour movie took two hours on a Hewlett-Packard computer I have with a 2.0 Gigahertz Pentium 4 chip—and more than three hours on my older Pentium III machine. Finally, I pushed a blank disk into my PC. But a little box popped up

me no dice.

on screen telling The reason: My movie was too long. In fact, all three programs I tried let me put together movies that exceeded the capacity of the disk—with no warning until it was time to burn. And in each case I had to go back almost to square one and recreate my movie, this time shorter, but all the while able only to guess what the right length might be. Each disk should hold as much as two hours, depending on the settings you choose, but none of the programs was terribly clear about how much video would fit.

Once I got my burned DVDs in hand, though, watching all of those glorious—and indecorous—moments from years past was a breeze. I even burned some extra copies for my in-laws. Now, I just have to get them to buy a DVD player. ■

Videos—on DVD

PC. But the results can be worth the trouble. **BY DAVID ROCKS**

An Edgy Family Car

The redesigned 2003 Accord has power to spare. **BY LARRY ARMSTRONG**



IF ASKED TO NAME the quintessential family sedan, many moms and dads would choose the Honda Accord. Yet families weren't the first thing on Honda's mind when it set out to overhaul its best-selling Accord for the 2003 model year. It aimed to please buyers who want more excitement and performance in their cars.

Did Honda succeed? I think so. After test-driving various versions, including the upscale \$24,100 EX, I found a car that's edging more toward a European look and road feel than its predecessor. It has a stiffer body, a more sophisticated suspension that handles better around corners, and bigger wheels. Even the 160-horsepower, four-cylinder engine, new this year, is faster off the mark than last year's, and the 240-hp V6 is a virtual match for the Nissan Altima—and packs 50 hp more than either the Toyota Camry or Volkswagen Passat.

The ride is smooth and taut, and the Accord sits tight even when you take the curves faster than you should. Steering is natural, even at high speeds, and doesn't kick back when you're cornering on a bumpy surface. In its V6 incarnation, with the bigger engine and bigger tires, the Accord can be downright lusty.

Even so, you'll never mistake this for anything other than an Accord. It still looks like a family sedan, although it's not as conservatively styled as in the past. It has a pro-

nounced wedge shape, a more aggressive front, and a more muscular look around the front wheels.

Inside, it's filled with little luxuries. Even on the \$16,260 base model, the steering wheel telescopes and tilts, the driver's-seat height is adjustable, and antilock brakes are standard. The floor in the passenger compartment is flat, and map pockets or doors can accommodate water bottles. The instrument panel

MUSCLE AND POLISH:

Behind the meek-looking exterior is an interior filled with luxuries



which is dark when the car is parked, lights up in stages to a Lexus-like elegance when you open the door, insert the key, and turn on the engine. It's even better as you move up the line of models, starting at \$19,660, come with keyless entry, and the remote buttons are built into the key rather than a fob. EX models get individual climate controls for the driver and passenger.

One less-than-luxurious element is the way Honda handles side air bags. Side air bags cost \$250 on low-end models. Side curtain bags that drop down to protect your head in crashes are available only in the top-of-the-line EX V6 models, which start at \$26,360. Still, you get a lot for your money with the new Accord, including doodads you'd expect to find only in much pricier cars. The Accord has been No. 1 or No. 2 best-selling car in the U.S. since 1989. This year's refinement and polish should keep it at the top.

LOANS

Tune Up Your Car Loan



Now that you've refinanced your house, what about your car? If you bought the vehicle with a loan a year ago, you're probably paying **8% on the borrowed amount**. But with refi rates on almost-new cars below **6%**, you could save several payments by the end of the

original five-year loan (table). Unlike mortgage refis, you don't pay closing costs on a rejiggered auto loan, though you may pay a small fee to transfer the title to a new lender.

LowerMyBills.com, which works with several lenders, offers good rates. A unit of Capital One Financial, PeopleFirst.com has a 5.49% rate for up to 36 months, and

5.95% for four or five years. To help, check out the calculator at PeopleFirst.com. *Ronald G.*

MORE MONEY FOR GAS

	5-YR. LOAN AMOUNT	RATE	MONTHLY PAYMENT
Year 1	\$10,000	8.00%	\$202.71
Year 2	8,300	5.95	194.74
Total	Savings by Year 5: \$385		

Data: PeopleFirst

MISSION HOCKEY IS PLAYING TO WIN.



IBM

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Winning in Enterprise Resource Planning: Mission Hockey is bringing hockey equipment to the world more efficiently than ever. They chose IBM Business Partner Intenia's Movex software, running on IBM @server™, for better inventory control, order processing and rapid ROI. Get in the game at ibm.com/e-business

@business is the game. Play to win.™

Putting Your Eggs in Many Baskets

Investors find new uses for exchange-traded funds.

BY SUSAN SCHERREIK

IVEN IN A bear market, exchange-traded funds (ETFs) are hot. This year, investors have poured \$33 billion into these baskets of securities that mimic index funds but trade like stocks.

What's the appeal? In the aftermath of Enron and WorldCom, investors are increasingly skittish about individual stocks—even shares of seemingly solid companies. Because ETFs are baskets of stocks in both broad and narrow indexes, “you’ve greatly reduced single-company risk,” says Merrill Lynch ETF analyst Benjamin Bowler. Diversification makes ETFs similar to mutual funds, but they work more like stocks. You can trade them all day, buy them on margin, or sell them short. You can also trade options on many of these funds.

Investors are finding lots of neat applications for these instruments. Here are a few of them:

ASSET ALLOCATION

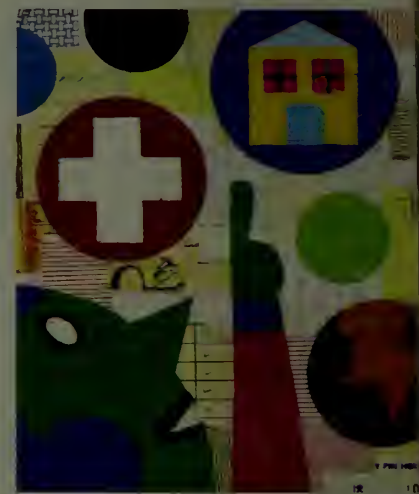
With the recent launch of ETFs tied to bond indexes, it's now possible to build a portfolio that's diversified across sectors and

asset classes. And you don't have to settle for the Standard & Poor's 500 Depositary Receipts (SPDR), or “spiders,” as a proxy for stocks. Using ETFs that track the different sectors of the S&P 500, you can fine-tune your holdings. If you think health stocks will outpace the S&P 500 and financial stocks will lag, you can build that bias into your portfolio.

Look at the stock portfolio designed by investment adviser Thomas Mench, chairman of Mench Financial in Cincinnati (table). He invests in most of the nine sector SPDRs—each is a basket of the stocks in a different slice of the S&P 500. Mench overweights consumer discretionary, technology, and utilities

those sectors will outpace the market next year. Conversely, the portfolio avoids energy stocks and is underweighted in health-care and industrial stocks.

For fixed income, Lehman Brothers ETF analyst Alex Bundy created a portfolio with the Lehman Brothers Aggregate U.S. Bond index as the benchmark. Based on Lehman bond guru Jack Malvey's views, the portfolio is overweighted in corporate bonds



and underweighted in Treasuries, especially short maturities.

Using sector ETFs instead of a broader index gives you more control over your asset allocation, but there's a drawback. You'll pay more in commissions if you buy sector ETFs rather than the S&P 500 SPDR. But with online commissions, that shouldn't be a major hurdle.

THE SECTOR BET

You think energy stocks are a good bet for the long term, but you are concerned they will stumble over the next few months. You could buy now—Energy Select Sector SPDR Fund trades at \$21.90. Or you could wait until next year, but then you risk missing an upward move.

There's another approach: Sell a

TWEAK YOUR ASSET ALLOCATION

STOCKS*	SYMBOL	SUGGESTED WEIGHTING	BENCHMARK** WEIGHTING	PRICE
Consumer Discretionary	XLY	20%	14%	\$24
Consumer Staples	XLP	5	10	20
Energy	XLE	0	6	21
Financial	XLF	25	21	22
Health Care	XLV	5	15	27
Industrial	XLI	5	11	20
Materials	XLB	5	2	19
Technology	XLK	25	18	15
Utilities	XLU	10	3	18

BONDS

Lehman 1-3 Yr. Treasury	SHY	7%	22%	\$81
Lehman 7-10 Yr. Treasury	IEF	13	10	85
Lehman 20+ Treasury	TLT	17	13	87
GS \$ Investop Corporate	LQD	64	55	107

Stock ETFs are all Standard & Poor's Select Sector SPDRs. Bond ETFs are Barclay's iShares.
 **Benchmark for stocks is the S&P 500; for bonds, Lehman Bros. U.S. Aggregate Bond Index.
 ***Nov. 18 Data: Mench Financial, Lehman Brothers



HOW TO MILK A BOND

Nowadays, most investors are thinking about selling their losing stocks. But what about your winning bonds? **Robert Gordon**, whose investment firm Twenty-First Securities specializes in tax-efficient strategies, says there's an easy way to lock in today's bond gains while shaving your tax bill. Here's how: Let's say that two years ago you bought a five-year corporate with a 6% coupon and paid its \$1,000 face value.



Interest rates have since fallen, so now the bond sells for \$1,120 and yields 2% to maturity.

■ **STEP ONE** You sell the bond, netting \$120. Come Apr. 15, you'll owe long-term capital gains taxes. (We'll assume the maximum 20% rate.)

■ **STEP TWO** You immediately buy back the bond. Over the next three years, until the bond matures, you'll continue to owe income taxes on the coupon payments of \$60 a year. (We'll assume the top 38.6% federal rate.) But you also get to write off that \$120 premium you paid for the bond. That slashes \$40 a year off that taxable income.

■ **THE RESULT** After taxes, you'll earn a 4.4% annual return on the bond, vs. 3.6% if you simply hold it to maturity.

To see if this strategy is worth it in your situation, use the handy bond calculator at twenty-first.com.

Susan Scherreik

on the energy
Choose the op-
that expires in
and allows the
on buyer to sell
100 shares at \$21
For that right,
option buyer pays
a fee of \$1.55 a
e, or \$155.

energy stocks
a near-term
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the premium re-
s your net cost
19.45. And if en-
stocks zoom?
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unexercised. You
then buy the en-
stocks at a high-
price, but the op-
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profit. One

eat: Transaction costs on small
les can eat into your profits. That's
y Michael Schwartz, chief options
tegrist at CIBC Oppenheimer, sug-
sts doing this trade with no fewer
n 10 options contracts, represent-
1,000 ETF shares.

PORTFOLIO INSURANCE

toeing back into the stock
ket? A combination of ETFs
options can be a smart way
lo it.

Let's say you buy the Dia-
nd Series Trust I,
er known as Dia-
nds. That's the ETF
t tracks the Dow
es industrial average.
can buy it at \$85.25
hare, but you're con-
ned that the Dow
drop again. So you
put options on Dia-
nds with a strike
e of \$84 a share,
iring in January,
5. That means
the next two
rs, you can al-
s sell your Dia-
nds at \$84. For
t portfolio insur-
e on 100 shares
the Diamonds,
ll pay \$1,180—
cost of the op-
s contract. Sure,
ne Dow rockets

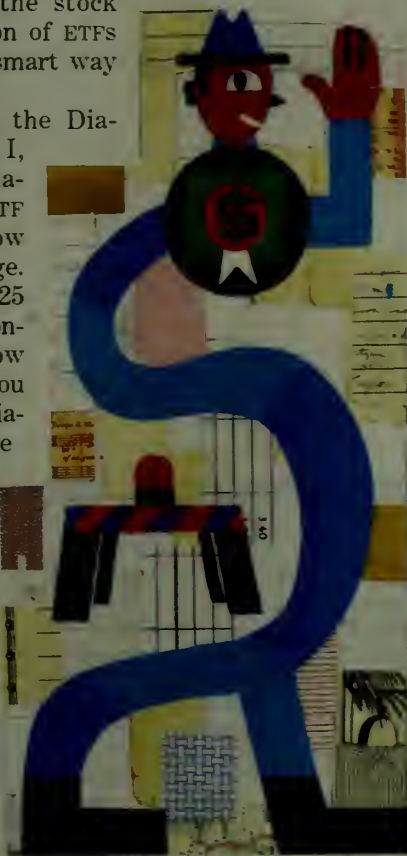


back over 10,000, your option is worth-
less—but you'll have peace of mind.

THE TAX TRADE

Now's the time of year when you want
to sell stocks to generate tax losses.
But what about the stocks you think
still have potential? The tax code says
you must wait 31 days after selling to
buy back a stock or
forfeit your write-off.
What if the stock you
sold rallies during that
period?

A good strategy is
to replace the sold
stock with an ETF
that's heavily invested
in the stock you're
unloading. Suppose
you've lost money in
Verizon Communica-
tions, which, like most
of the telecom indus-
try, is in the dumps.
You could sell Verizon
and buy the iShares
Dow Jones U.S.
Telecommunications
Fund as a placeholder.
That fund has 25% of
its assets in Verizon.
Then, after 31 days,
you can buy back the
Verizon stock and sell
the fund shares. Or
you just might find
that investing in ETFs
suits you better. ■



Closed-End Treasure?

Bargains are surfacing as tax-loss selling begins.

BY MARA DER HOVANESIAN



SPRING CLEANING in winter? It's that time of year when closed-end investors start culling their portfolios for losses that will help lighten their tax load next year. Often, that tax-loss selling creates opportunities for those waiting on the sidelines to buy closed-end funds on the cheap.

While prime time is still a few weeks away, closed-end fund specialist Thomas Herzfeld of Miami says you should start doing your homework now. "Don't step on the gas yet," he says. "They'll probably get a little cheaper in December, when the tax selling gets heaviest. Then

you'll get a good rally in January, even if the market isn't doing well."

Like mutual funds, closed-ends hold securities whose prices fluctuate with the market. Their net asset value (NAV), or market value of the securities owned, also fluctuates. Closed-end funds differ from mutual funds in that they have a fixed number of outstanding shares, which trade on the stock exchanges.

The closed-end market trades inefficiently, so shares of such funds trade at prices that differ from NAV, often at discounts. The discounts typically widen at yearend and shrink again in January, creating the chance to make money not only on the fund's appreciation but on the narrowing discount: If its NAV is \$10 and its market price is \$8, the fund

trades at a 20% discount. As demand for the fund's shares rises, so does its value. Ultimately, the discount is eliminated or bid up to a premium.

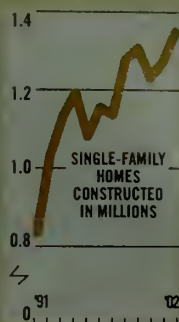
INTEREST-RATE RISK

Right now, the best bets are still in funds that invest in municipal bonds. Herzfeld moved his muni portfolio from an all-cash position to 30% the past few weeks. He'll be 100% vested by mid-December, he says. Some recent buys include Managed Municipals Portfolio and Insured Municipal Income Fund, national funds with yields more than 6%. That's the equivalent of more than 9% in a taxable bond for an investor in the 30% tax bracket. But big risk remains: Rising interest rates

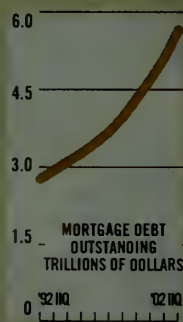
Crash Worries

Has the housing market peaked? Here are three reasons to think that home prices have peaked:

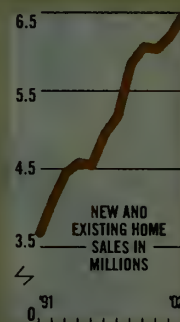
Data: Economy.com



The number of single family homes constructed rose from 35,000 units in 1991 to 135 million in 2002.



Mortgage debt outstanding exploded from \$2.75 trillion to \$5.6 trillion between 1992 and 2002.



New and existing home sales hit a record high of 6.5 million in 2002, up from 3.76 million in 1990.

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are a negative for most bond funds, because prices move in the opposite direction of interest rates. When the portfolio is leveraged—as most closed-end muni funds are—that potential loss is magnified.

Closed-end investors considering funds to buy might also think about a few to dump. Outsized premiums often raise red flags. Investors have bid up the shares because of the astronomical yields they're paying. The high-yield Zenix Income Fund, which has a premium of 16.6%, also has a 16.7% yield. But payouts like that are unsustainable, says Don Cassidy, Lipper's senior closed-end analyst. "They're overpaying, and they're going to have to cut the dividend."

Interest-rate sensitivity aside, some discounts are simply a function of market mispricing. Adams Express, for instance, sells for a 11.8% discount, and for no good reason, says Amy Hawkins, director of closed-end fund research at Raymond James & Associates. The fund is on Hawkins' buy list: It's one of the

FIRE SALE PRICES ON CLOSED-ENDS

FUND SYMBOL	PREMIUM(+)/DISCOUNT(-) DURING 2002		CURRENT DISCOUNT	SHARE PRICE
	HIGH	LOW		
U.S. EQUITY				
Equus II EQS	-47.9%	-37.7%	-44.9%	\$6.51
meVC Draper Fisher Jurvetson I MVC	-43.5	-27.9	-32.4	8.11
Renaissance Growth & Inc. III RENN	-25.7	-2.3	-20.0	7.62
John Hancock Finl. Trends JHFT	-19.8	-12.5	-19.8	12.45
FOREIGN EQUITY				
Thai Capital TF	-34.1	13.9	-25.1	3.10
New Ireland IRL	-27.3	-12.5	-22.7	8.95
First Israel ISL	-22.6	-13.8	-21.8	7.96
New Germany GF	-22.4	-11.7	-20.2	3.60
TAXABLE BOND				
Pilgrim Prime Rate PPR	-17.8	-1.8	-17.0	5.46
Aberdeen Asia-Pacific Inc. Fund FAX	-19.6	-3.4	-16.7	4.30
Boulder Growth & Income BIF	-20.1	-2.4	-15.4	5.31
MSDW Emg. Mkts. Debt MSD	-12.8	-0.1	-12.8	7.25
MUNICIPAL BOND				
Putnam Tax-Free Health Care PMH	-14.9	-9.0	-14.9	11.78
Van Kampen Muni Income VMT	-14.6	-9.9	-14.3	8.77
Van Kampen Inv. Grade Muni. VIG	-14.5	-8.6	-13.6	8.65
Seligman Select Muni. SEL	-13.5	-8.4	-13.5	10.36

Data as of Nov. 15

Data: Morningstar

oldest and most conservative funds on the market. It invests in large blue-chips such as American International Group, Coca-Cola, and Pfizer, and has a

10-year average total return of more than 11% on price. Amy Hawkins recommends the meVC Draper I Jurvetson Fund I: Its venture-capital holdings in technology startups are risky. But at a 32% discount, she says the shares are below cash value, making it attractive for investors looking for a speculative bet.

EUROPEAN ATTRACTION

Many closed-end European funds are also selling at discounts. As attractive as that may be, a stock market that may not be a bargain may not be a bargain for underlying assets in biotech or Thai equities are heading south. If you're bullish on stocks, bonds, "then it's a good time to get into closed-end funds," says David B. B. head of closed-end funds at J.P. Morgan Fleming & Management. He's keen on European closed-ends, in some cases are selling

double-digit discounts, including the European Warrant and the France Growth funds. When those markets recover, investors will be rewarded twice.

YOUR HOME

CO Gas: Thwarting an Invisible Killer

Every fall, as families fire up their gas furnaces and fireplaces, there's an outbreak of carbon monoxide poisonings. CO has become the leading cause of accidental poisoning deaths in the U. S., at more than 2,000 a year.

Incomplete combustion of fossil fuels is the culprit. The best defense: Check the chimney



LINE OF DEFENSE: The Nighthawk alarm tracks CO levels

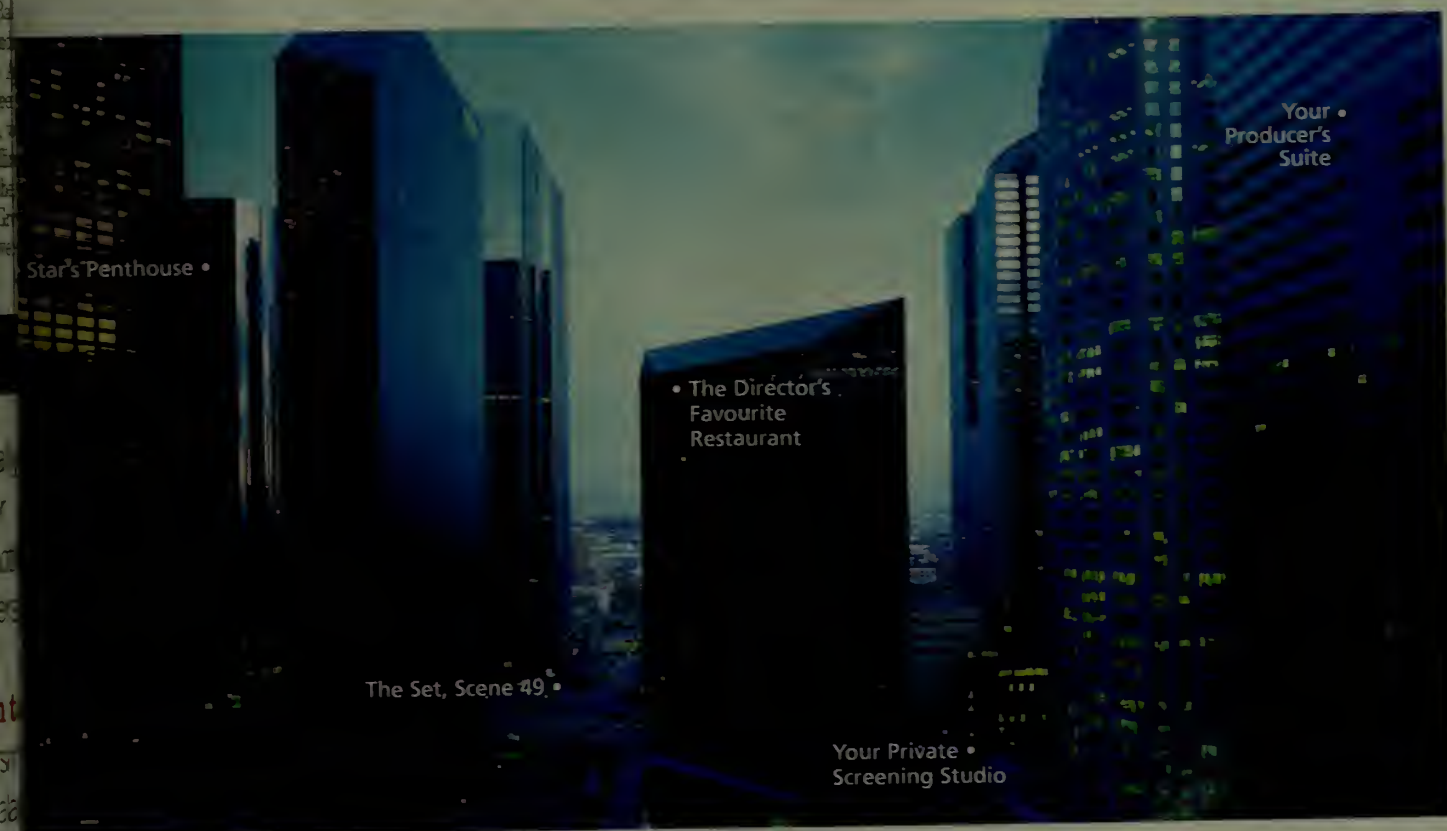
and furnace annually. Look for blocked or cracked vents on clothes dryers, water heaters

and stoves. **Never use a barbeque grill or an oven to heat a room.** You can't see or smell the gas, so it's prudent to get a CO alarm for \$25 to \$50. Some cities require

Kidde's Nighthawk Premium Plus and Senco's Model One have peak-level memories, which keep track of the highest CO level. That lets you spot problems before the alarm goes off.

Larry Armstrong

Exactly where would
you like our chauffeur
to pick you up?



When you fly First Class or Golden Club Class with us from New York or Los Angeles, we'll have a chauffeur driven sedan pick you up when you leave. And waiting for you when you return. This service extends to any point within a 40 mile radius of the airport. It's our way of ensuring you have a smoother, faster, more comfortable flight. Even before you get on the flight. **Malaysia Airlines. Going beyond expectations.**





Schwab: Breaking the Code of Silence

BY ROBERT BARKER rb@businessweek.com

BROKERAGE GIANT Charles Schwab studiously avoided giving clients its own advice on individual stocks for its first 28 years. For the past six months, Schwab has been doing just that, every week, via report cards on over 3,400 stocks. If you hold one of Schwab's 8 million accounts, or if you're thinking of opening one, you've got to wonder: Are Schwab's stock grades worth following more than the Wall Street "research" that has turned 2002 into the Year of the Deadbeat Stock Analyst?

We should see soon enough. Jerry Chafkin, Schwab's man in charge of investment advice, told me the firm is busily creating a Web site to publicize continuously how well or poorly the Schwab Equity Ratings pan out. The site is due to appear by May at the latest, when the ratings scheme marks its first anniversary, and perhaps sooner. "We're willing to be held accountable for our research," Chafkin said.

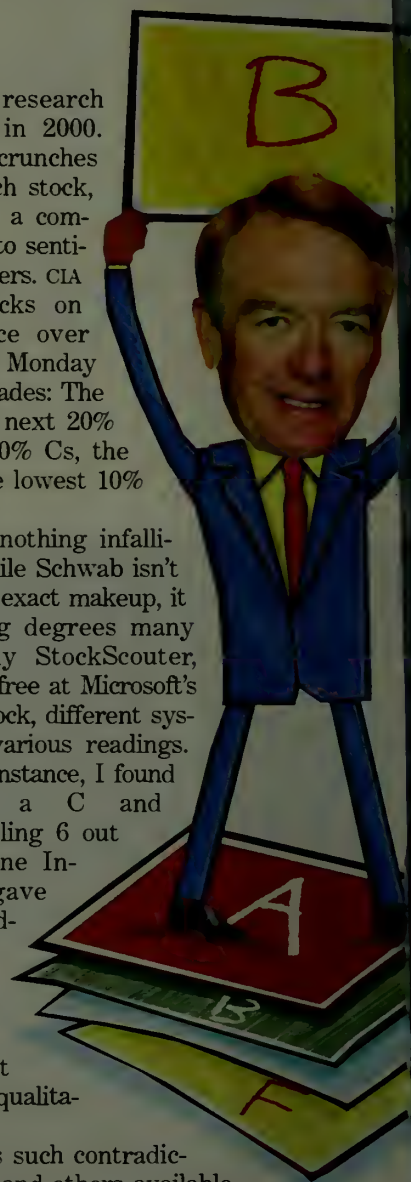
This would seem a small step for humanity, except such open performance reporting of brokerage-firm advice is hard to come by on Wall Street, even if you have subpoena power. "It was surprisingly difficult for us to gather the data necessary to objectively measure analyst performance," New York State Attorney General Eliot Spitzer told a group of analysts at a Nov. 12 dinner. "After spending hundreds of hours listening to investment banks and their lawyers lecture about the efficiency of the marketplace, I'm still disappointed to learn that they withhold" data the market needs.

Schwab's method of rating stocks was developed by Chicago Investment Analytics, or

CIA, a quantitative research boutique it bought in 2000. Each weekend, CIA crunches 24 data items for each stock, from the strength of a company's free cash flow to sentiment among short-sellers. CIA then ranks the stocks on probable performance over the coming year. By Monday morning, it assigns grades: The top 10% get As, the next 20% get Bs, the middle 40% Cs, the next 20% Ds, and the lowest 10% are Fs.

Naturally, there's nothing infallible about all this. While Schwab isn't disclosing the model's exact makeup, it resembles in varying degrees many others, most notably StockScouter, which is available for free at Microsoft's MSN. On any given stock, different systems will give you various readings. For ExxonMobil, for instance, I found Schwab gave it a C and StockScouter a middling 6 out of 10. But Value Line Investment Survey gave ExxonMobil its second-lowest score, while Standard & Poor's (part of The McGraw-Hill Companies, as is *BusinessWeek*) gave it five stars, tops in its qualitative STARS system.

Schwab still makes such contradictory advice from S&P and others available to clients. Yet it is highlighting its own ratings, and the firm also is running two mutual funds, Sch Core Equity and Schwab Hedged Equity, based on the latter fund not only buys high-rated stocks but also short the low-rated ones. The strategies have been in place only a few months, so it's too soon to judge them. As for rating system overall, Schwab so far is saying only that in first six months the market returns of its A stocks are all of Bs, Bs beat Cs, and so on. Yet once the firm begins posting the performance of its ratings on the Web, the stark question will be: Which other brokers will dare to account openly their picks and pans?



Schwab's Top of the Class...

COMPANY*/SYMBOL	PRICE**	Schwab Equity Rating
Dell Computer DELL	\$30.94	A
DuPont DD	42.78	A
Fannie Mae FNM	66.38	A
Johnson & Johnson JNJ	60.46	A
Procter & Gamble PG	86.48	A

...And the Bottom

COMPANY*/SYMBOL	PRICE**	Schwab Equity Rating
ChevronTexaco CVX	\$67.20	F
Chubb CB	57.35	F
Costco Wholesale COST	33.44	F
KLA-Tencor KLAC	37.62	F
Univision Communications UVN	29.12	F

*Biggest market-cap companies in each rating group **Closing prices, Nov. 14; ratings as of Nov. 11 Data: Charles Schwab & Co.

BusinessWeek online

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es, 3 hotels, 1 rental car, and only 3 days to do it all. Need advice? Introducing USATODAY.com Travel, a new source for real-time travel information, news, and features.

ahead and save time with exclusive features like:

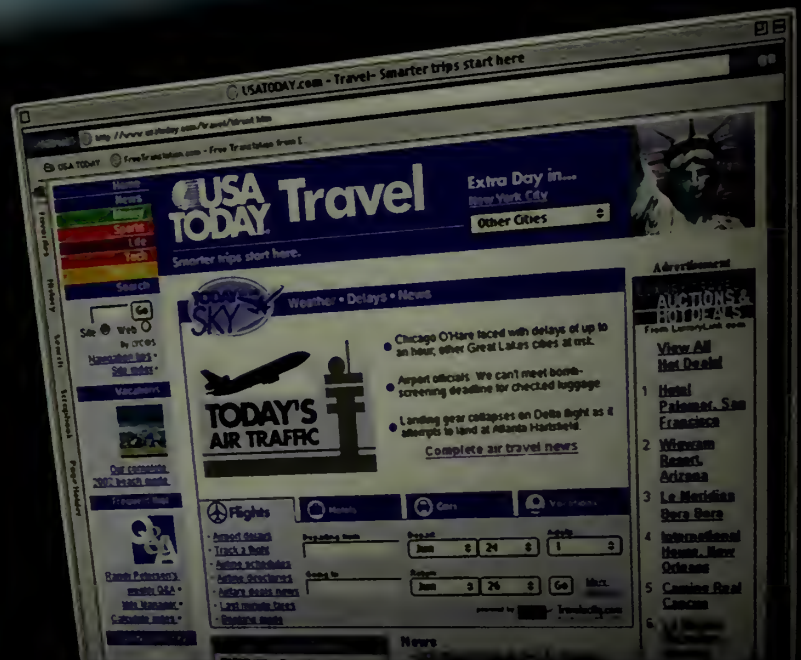
in the Sky – Real-time airport status, travel news, and city-by-city weather reports

a Day In – Now mix pleasure with business, no matter how short your stay

live chats – Chat with industry experts and insiders for news, tips, and tricks

USATODAY.com Travel combines the insight and experience of USA TODAY with minute-to-minute access to travel news and information, exclusively online 24 hours a day, 7 days a week.

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**ITS RICH ASSETS DON'T SHOW UP IN LIBERTY MEDIA'S LOW STOCK PRICE
MAINLY BY PARING COSTS, XEROX WILL SHOW A PROFIT FOR 2002
THRIVING INVERNESS MAY BE READY TO SELL IN A YEAR OR TWO**

BY GENE MARCIAL

Liberty: Going Cheap

Liberty Media (L), cable mogul John Malone's investment outfit, is the "most attractive way to play the media and entertainment industries." So says Martin Sass, CEO of M.D. Sass Group, which manages \$7 billion and has been buying shares. Liberty trades at a nearly 50% discount to the value of its assets, figures Sass. Liberty's stock is at 9, and he estimates its assets are worth 18.75 a share. Douglas Mitchelson of Deutsche Bank Securities agrees, urging investors to "take advantage of this widening value gap." Deutsche Bank has done banking for Liberty this year and owns 1% of the stock.

Sass sees the stock at 15 in a year, based on assets alone. He says 80% of Liberty's value is wrapped up in six companies, three public and three private: Liberty owns 21% of USA Interactive, 18% of News Corp., and 3.7% of AOL—plus 100% of Starz Encore Group, 49% of Discovery Communications, and 42% of QVC.

Chairman Malone, according to Sass, is out to widen the scope of his global holdings. Latest quarry: Vivendi Universal's American assets, including the Universal film studio. Malone and USA Interactive CEO Barry Diller, who also heads Vivendi's U.S. businesses, are in talks, says Sass. Given Vivendi's woes, including a Securities & Exchange Commission probe into its financial disclosures, it might sell its assets or merge them with Liberty, he adds. Liberty CEO Robert Bennett has told analysts that Liberty also wants to team up with NewsCorp. to buy Hughes Electronics' DirecTV unit and some AOL assets. Liberty didn't return calls. Vivendi declined comment.

Xerox' Image Is Getting Crisper

Two years ago, Xerox (XRX) was on the brink of filing for bankruptcy—or being taken over. Neither came to pass. Today, the world's largest maker of copiers is on a recovery kick, thanks to the efforts of Anne Mulcahy, who took over as CEO last year. "She has done a masterly job of healing a wounded bird," says Robert Morris, chief investment officer at mutual-fund outfit Lord Abbett, which manages \$46 billion and owns 47 million shares, or 6.5%, of Xerox. The company is not out of

the woods, but things are looking up, observes Morris. On 19, Xerox said it would eliminate a further 2,400 jobs in America and close more plants. Mulcahy cut 13,600 jobs last year to slash expenses by \$1.1 billion. Most analysts remain negative, but Xerox shares, down to 4.42 in October, had nearly doubled, to 8.25, by Nov. 20. Sales have yet to perk up, but Xerox posted third-quarter earnings of \$105 million, or 5¢ a share, mainly through cost-cutting. And it could be in the black for all of 2002—the first time since 1999 that it will post a yearly profit. According to Zacks Investment Research, Xerox is expected to earn 9¢ in the quarter, 22¢ for all of 2002, and 56¢ in 2003.



Is Inverness Being Fattened Up for Market?

Watchers of Inverness Medical Innovations (IMA) think CEO Ron Zwanziger might again—that is, turn a medical-tech startup profitable and sell it to a big drugmaker. In the early '90s, Zwanziger formed MediSense, which he sold in 1995 to Abbott Labs for \$880 million. He then formed Inverness Medical Technology, developing a device to monitor blood glucose for diabetics. Johnson & Johnson acquired it in mid-2001 for \$1.3 billion. Then he spun off its Inverness Medical Innovations unit, which Zwanziger took back. It focuses on women's health and pregnancy test kits, selling products at Walgreens and cvs. Inverness sales are expected to zoom from 2001's \$49 million to \$240 million in 2002, aided by acquisitions that added \$190 million to sales. Sales could top \$300 million in 2003 and approach \$1 billion in 2004, says one fund manager, who owns shares. He sees the stock, now at 10, hitting 30 in a year and reckons Zwanziger will sell Inverness in a year or two. Scott Wilkin of SC Cowen Securities, who did banking for Inverness this year, figures it will earn 3¢ in 2003 and 75¢ in 2004—way up from 2002's estimated 5¢.



BusinessWeek online Read Gene Marcial's Inside Wall Street Online column Tuesday afternoons at www.businessweek.com today.htm. And see him Fridays at 1:40 p.m. EST on CNN's *The Money Gang*.

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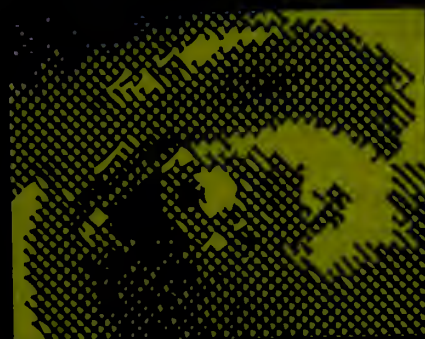
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— Bruce Nussbaum, H/IDSA, Design Editor at BusinessWeek

BusinessWeek Investor FIGURES OF THE WEEK

STOCKS

S&P 500

Nov. May Nov. Nov. 14-20



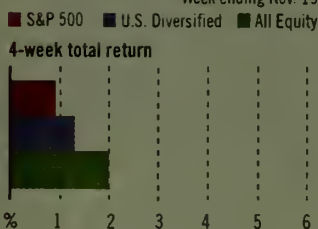
COMMENTARY

The markets posted gains for the week ended Nov. 20—not on any good news, but rather a dearth of bad news. Big tech stocks—IBM, Intel, and Cisco—helped push NASDAQ up 4.3% for the week. And while the blue-chip Dow has surged more than 18% off its 5-year lows hit on Oct. 9, Wall Street analysts continue to be guarded about the current market momentum.

Data: Bloomberg Financial Markets (Reuters)

MUTUAL FUNDS

Week ending Nov. 19



Week ending Nov. 19



Data: Standard & Poor's

U.S. MARKETS

	NOV. 20	WEEK	% CHANGE YEAR TO DATE	LAST 12 MONTHS
S&P 500	914.2	3.6	-20.4	-20.0
Dow Jones Industrials	8623.0	2.7	-14.0	-12.9
NASDAQ Composite	1419.4	4.3	-27.2	-24.5
S&P MidCap 400	434.5	3.7	-14.5	-9.5
S&P SmallCap 600	197.5	2.6	-15.0	-8.1
Wilshire 5000	8619.4	3.5	-19.5	-18.1

SECTORS

BusinessWeek 50*	565.8	2.0	-22.5	-23.7
BusinessWeek Info Tech 100**	301.8	3.7	-28.0	-26.1
S&P/BARRA Growth	473.6	3.0	-20.3	-20.1
S&P/BARRA Value	437.3	4.2	-20.8	-20.4
S&P Energy	184.1	5.7	-12.9	-9.6
S&P Financials	310.9	4.8	-12.5	-11.5
S&P REIT	89.6	1.6	-4.1	-1.8
S&P Transportation	169.4	-0.1	-14.0	-11.7
S&P Utilities	92.2	4.0	-36.8	-39.3
GSTI Internet	83.6	7.2	-20.3	-14.3
PSE Technology	487.4	6.2	-29.1	-26.1

*Mar. 19, 1999=1000 **Feb. 7, 2000=1000

BEST-PERFORMING GROUPS

	LAST MONTH %	LAST 12 MONTHS %
Wireless Services	47.8	29.4
Office Electronics	38.9	24.1
Networking Equipment	36.9	22.0
Computer Stge. & Perphs.	33.0	20.9
Instrumentation	26.6	19.5

EQUITY FUND CATEGORIES

4-WEEK TOTAL RETURN	%	52-WEEK TOTAL RETURN	%
LEADERS		LEADERS	
Technology	10.5	Precious Metals	54.4
Communications	8.5	Real Estate	5.2
Diversified Emerging Mkts.	4.9	Diversified Emerging Mkts.	1.0
Precious Metals	4.9	Pacific/Asia ex-Japan	-0.3
LAGGARDS		LAGGARDS	
Japan	-2.6	Communications	-39.6
Health	-0.6	Technology	-37.6
Financial	-0.4	Health	-27.0
Miscellaneous	-0.3	Utilities	-26.8

EQUITY FUNDS

4-WEEK TOTAL RETURN	%	52-WEEK TOTAL RETURN	%
LEADERS		LEADERS	
Jacob Internet	32.1	First Eagle SoGen Gold	88.1
American Heritage	28.6	Monterey OCM Gold	71.6
ProFunds UltraSemicondtr.	27.9	Tocqueville Gold	70.5
ProFunds UltraWireless	25.6	Van Eck Intl. Invs. Gold A	69.6
LAGGARDS		LAGGARDS	
Fidelity Sel. Medical Del.	-20.9	ProFunds UltraWireless	-78.2
ProFunds UltraShort OTC	-14.8	Rydex Dynam. Veloc. 100	-64.4
Rydex Dynam. Vent. 100	-14.7	World GenomicsFund.com	-64.1
COC Nvest Targeted Eq. A	-12.7	Black Oak Emerging Tech.	-63.1

GLOBAL MARKETS

	NOV. 20	WEEK
S&P Euro Plus (U.S. Dollar)	854.5	3.2
London (FT-SE 100)	4094.9	1.6
Paris (CAC 40)	3153.5	3.9
Frankfurt (DAX)	3213.0	4.8
Tokyo (NIKKEI 225)	8459.6	0.3
Hong Kong (Hang Seng)	9971.2	3.7
Toronto (S&P/TSX Composite)	6493.1	3.0
Mexico City (IPC)	5641.7	-3.8

FUNDAMENTALS

	NOV. 19	WEEK
S&P 500 Dividend Yield	1.76%	1
S&P 500 P/E Ratio (Trailing 12 mos.)	29.2	2
S&P 500 P/E Ratio (Next 12 mos.)*	16.2	1
First Call Earnings Revision*	-2.63%	-2

TECHNICAL INDICATORS

	NOV. 19	WEEK
S&P 500 200-day average	989.2	994
Stocks above 200-day average	22.0%	21
Options: Put/call ratio	0.65	0.
Insiders: Vickers NYSE Sell/buy ratio	1.59	1.

WORST-PERFORMING GROUPS

	LAST MONTH %	LAST 12 MONTHS %
Health-Care Facilities	-35.0	Multi-Utilities
Home Improvement Stores	-16.3	IT Consulting
Managed Health Care	-13.8	Telecomms. Equip.
Commercial Printing	-13.5	Tires & Rubber
Housewares & Specialties	-8.9	Wireless Services

INTEREST RATES

KEY RATES

	NOV. 20	WEEK AGO
MONEY MARKET FUNDS	1.22%	1.28%
90-DAY TREASURY BILLS	1.21	1.20
2-YEAR TREASURY NOTES	1.94	1.73
10-YEAR TREASURY NOTES	4.06	3.84
30-YEAR TREASURY BONDS	4.94	4.79
30-YEAR FIXED MORTGAGE†	5.98	5.93

†Bar

BLOOMBERG MUNI YIELD EQUIVALENTS

Taxable equivalent yields on AAA-rated, tax-exempt municipal bonds, assuming a 30% federal tax rate

	10-YR. BOND
GENERAL OBLIGATIONS	3.75%
TAXABLE EQUIVALENT	5.36
INSURED REVENUE BONDS	3.90
TAXABLE EQUIVALENT	5.57

THE WEEK AHEAD

EXISTING HOME SALES Monday, Nov. 25, 10 a.m. EST ► Existing home sales very likely eased to an annual pace of 5.3 million in October, based on the median forecast of economists surveyed by MMS International.

GROSS DOMESTIC PRODUCT (REVISION) Tuesday, Nov. 26, 8:30 a.m. EST ► The Commerce Dept.'s second look at the third-quarter economy is expected to show that real GDP grew at an annual rate of about 3.0%, up from the initial level of 3.1%.

NEW RESIDENTIAL SALES Tuesday, Nov. 26, 10 a.m. EST ► New single-family home sales for October probably fell to an annual rate of 999,000, following a record pace of 1.02 million in September.

CONSUMER CONFIDENCE Tuesday, Nov. 26, 10 a.m. EST ► The Conference Board's November confidence index probably rebounded to 81.5, from 79.4 in October.

DURABLE GOODS ORDERS Wednesday, Nov. 27, 8:30 a.m. EST ► New orders for

durable goods are forecast to have climbed by 2.1% in October.

PERSONAL INCOME Wednesday, Nov. 27, 8:30 a.m. EST ► Both personal income and consumer expenditures probably rose by 0.3% during October.

BEIGE BOOK Wednesday, Nov. 27, 2 p.m. EST ► The Federal Reserve publishes its roundup of regional activity and gauge how business is doing in each of the Dec. 10 monetary policy

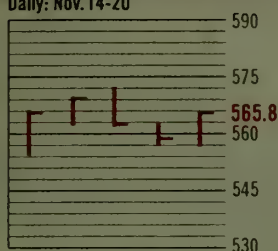
BUSINESSWEEK FIFTY

May

Nov.

Daily: Nov. 14-20

Weekly



50, up 2.0%, had a good week. Some previously battered stocks showed especially good returns: Dyn-40.2% after its new CEO said the company wouldn't file for bankruptcy. Household International shares 7.6% on news that it would be purchased by London's HSBC, and H&R Block jumped 21.9%, once it settle a class-action lawsuit in Texas. Tenet Healthcare recovered 20.6% despite news of SEC probes.

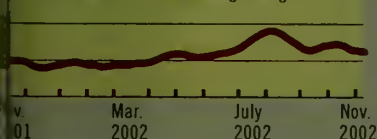
MY PERFORMANCE

COMPANY	% CHANGE		RANK	COMPANY	% CHANGE	
	WEEK	SINCE 3/1/02			WEEK	SINCE 3/1/02
Johnson & Johnson	0.1	-1.5	26	Tenet Healthcare	20.6	-53.6
Idie Mac	0.4	-8.7	27	Household International	27.6	-44.3
er	1.5	-19.2	28	WellPoint Health Networks	-1.7	21.9
IA	6.6	-6.1	29	Washington Mutual	0.5	6.7
ip Morris	-1.1	-28.2	30	Duke Energy	0.1	-47.3
Tencor	12.3	-31.2	31	Kohl's	7.4	-3.4
ie Mae	-1.8	-19.3	32	Bed Bath & Beyond	3.0	4.3
e's	-6.0	-16.2	33	Cardinal Health	-4.1	-1.6
Buy	29.0	-45.3	34	Centex	6.0	-20.8
resourceBergen	-9.2	-10.9	35	American Electric Power	2.7	-39.1
edHealth Group	-0.5	23.8	36	Golden West Financial	1.8	7.5
on	0.3	1.1	37	Stryker	3.2	8.6
ne Depot	-8.3	-50.6	38	Harley-Davidson	1.1	-3.4
-Mart Stores	-1.1	-12.3	39	PepsiCo	0.8	-13.4
egy	40.2	-95.5	40	Merck	8.9	-6.3
eral Dynamics	1.8	-11.5	41	Apache	5.0	-0.5
ocoPhillips	6.4	-16.1	42	Amerada Hess	7.3	-20.6
st Laboratories	2.2	30.2	43	KB Home	2.0	-0.3
k (H&R)	21.9	-25.7	44	First Data	-0.1	-15.9
ne	3.7	-54.8	45	Tyco International	9.2	-43.6
idental Petroleum	4.3	4.0	46	International Game Technology	4.1	15.9
o	-2.0	5.7	47	Capital One Financial	4.3	-40.4
e Homes	4.4	-13.7	48	Electronic Data Systems	4.2	-74.8
athon Oil	-3.2	-28.2	49	Nabors Industries	9.3	6.0
group	8.0	-10.9	50	Xcel Energy	15.5	-55.6

PRODUCTION INDEX

Change from last week: -0.2%
Change from last year: 1.8%

INDUSTRIAL OUTPUT Nov. 9=162.5 1992=100
The index is a 4-week moving average



Production index declined once again. Before calculation of the four-week moving average, the index fell 0.2% from 162.8. After seasonal adjustments, manufacturing and electric power production declined the most, so slipped, although a forecast from *Ward's Automotive Reports* calls for gradually improving volumes in November and December. Modest gains were seen in crude-oil refining, steel, and rail-freight. Coal and trucks showed small increases as well.

For more on each of the index components is at www.businessweek.com.
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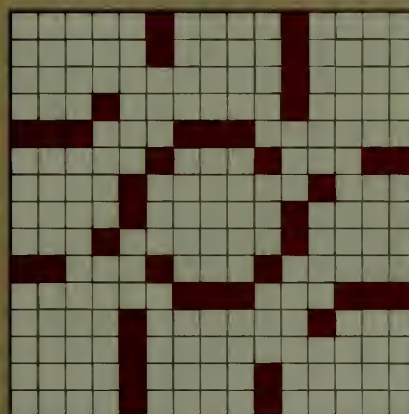
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For more investment data and the components of the production index, visit www.businessweek.com

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Community Development
Program of the Year

*National Thermal Power
Corporation, Ltd.*

Energy Company of the Year

*Consolidated Edison
Company of New York, Inc.*

Energy Engineering

Project of the Year
Kerr-McGee Corporation

Gas Company of the Year

ONEOK

Most Innovative Commercial
Technology of the Year

ConocoPhillips

Most Promising Pre-Commercial
Technology of the Year

*Composite Technology
Corporation*

Most Successful Strategy
Shift of the Year

Mirant

Oil Company of the Year

Suncor Energy Inc.

Power Company of the Year

Entergy Corporation

Renewables Company
of the Year

Enel SpA

Strategic Merger of the Year

Westmoreland Coal Company

Disclaimer: All judging decisions are made by Platts and an independent panel of distinguished energy experts. BusinessWeek and Deloitte Touche Tohmatsu serve only as sponsors of the awards and play no role in the judging criteria or the nomination or selection of winners.

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THE GOOD NEWS ABOUT PHILANTHROPY

The '90s gave us an era of enormous wealth creation and rising inequality. While almost everyone enjoyed the economic fruits of the decade, the gap between rich and poor widened. The last time this happened, in the Gilded Age at the turn of the 20th century, steel tycoon Andrew Carnegie called upon his cohorts to give much of their wealth to the poor and needy, and to do so in their own lifetimes. A century later, in 1997, Ted Turner challenged the high-tech, media, and finance billionaires of his time to do the same. And he gave away \$1 billion to start it off. Then came Bill Gates, who is far and away the most generous giver in history, donating fully 60% of his current net worth.

Turner's challenge and Gates's generosity are transforming philanthropy on a scale that outdoes the Carnegies, Rockefellers, and Fords. Thanks, in part, to the amazing stock market run-up, dented but not nearly depleted by the recent sell-off, charitable donations by individuals have grown by 50%, from \$110 billion to \$164 billion between 1990 and 2001. If present trends continue, philanthropy could total \$1 trillion more in this decade than in the previous one. To measure the progress of the current generation's generosity, *BusinessWeek* is composing an annual list of the 50 most generous American philanthropists (page 82). For some, anonymous do-

nations are the purest form of giving, and they, unfortunately, cannot be recognized. For others, the list will serve as a guide to philanthropy and to encourage it.

The new philanthropy consciously challenges the cautious, bureaucratic style of many of today's foundations. It is more personal, with philanthropists playing direct roles in their foundations. It is more strategic, with benefactors applying the systematic models they use in business to their philanthropic organizations. It is results-driven, with the new philanthropists demanding measurable results and attaching strings to the dollars to get them. Finally, the new philanthropy is global.

We don't yet know what impact the new philanthropists will have on the world. The previous generation of tycoons gave libraries to every American city, built world-famous research universities, and ended starvation in Asia. The challenges they faced involve urban education, AIDS in Africa, the environment, cancer, among others. Giving is a universal moral virtue, and the giving back to society in gratitude for opportunities received is quintessentially American. In a land of entrepreneurialism and mobility, the children of doctors and bankers, of parents born here and abroad, can do fabulously well. Many of those who did so in the '90s are now giving back, and America will surely benefit. Happy Thanksgiving!

SANDY WEILL'S HUMILIATION

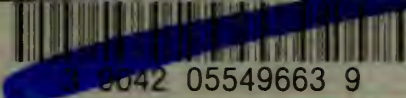
Sandy Weill has been a star performer on the stage of American finance for decades. He has acted with many of the major players of the day—Arthur Levitt, James Robinson, John Reed, and Robert Rubin. He has built empires, merging companies into financial behemoths. Today, he stands astride Citigroup, the ultimate universal bank, combining insurance and investment, commercial and corporate banking, in one synergistic stew. Weill's bank is enormously profitable—perhaps the most profitable company in the world. But Citigroup is built on conflicts of interest that have not been properly managed. Investors are suing, and Congress, the Securities & Exchange Commission, and New York State Attorney General Eliot Spitzer are investigating.

To his credit, Weill is responding by putting Citigroup in the forefront of Wall Street financial reform. Weill was one of the first CEOs to come out for expensing stock options. He replaced the head of Citigroup's scandal-ridden investment banking unit with his own general counsel. Most important, he moved to end the conflict of interest involving analysts being paid for generating investment banking business by hiving off global research and retail brokerage into a separate operation. Weill then hired Sallie L. Krawcheck, the former chief executive of Sanford C. Bernstein & Co., a leading independent stock research company, to head it. Krawcheck will report directly to Weill. Of all the proposals for financial reform cir-

culating on Wall Street, Weill's idea makes the most sense.

But Weill may have lost the moral authority to make such changes happen. As CEO, he is expected to manage the conflicts of interest inherent in a universal bank, but his personal conflicts of interest, revealed by leaked memos, e-mails, and his own public admissions, severely undermine his position. It is unseemly at best for Weill as CEO to ask Jack Grubman, Citigroup's key telecom analyst, to review AT&T's rating of Citigroup was vying for a big AT&T offering and Weill was sitting on its board of directors. It was unseemly, at best, for Weill to personally help Grubman's children get into a private school by calling the school's board and donating \$1 million of Citigroup money as a contribution. In the end, Grubman raised his rating on AT&T, Citigroup did get the business, and Grubman's children did get into the desirable school.

Quid pro quo? It's hard to believe otherwise. The deal has undermined Spitzer's confidence that Weill will properly manage the conflicts inherent in his relationship with Krawcheck. Spitzer says that as a result, Weill's model for reform is not sufficient. This is a great pity and a huge knock on Citigroup. In effect, Weill's own behavior now stands in the way of implementing his own reforms. For all his star performance, it may very well be time for Weill and the board of directors to start seriously thinking about him taking his final bows.



Business Week

BER 9, 2002

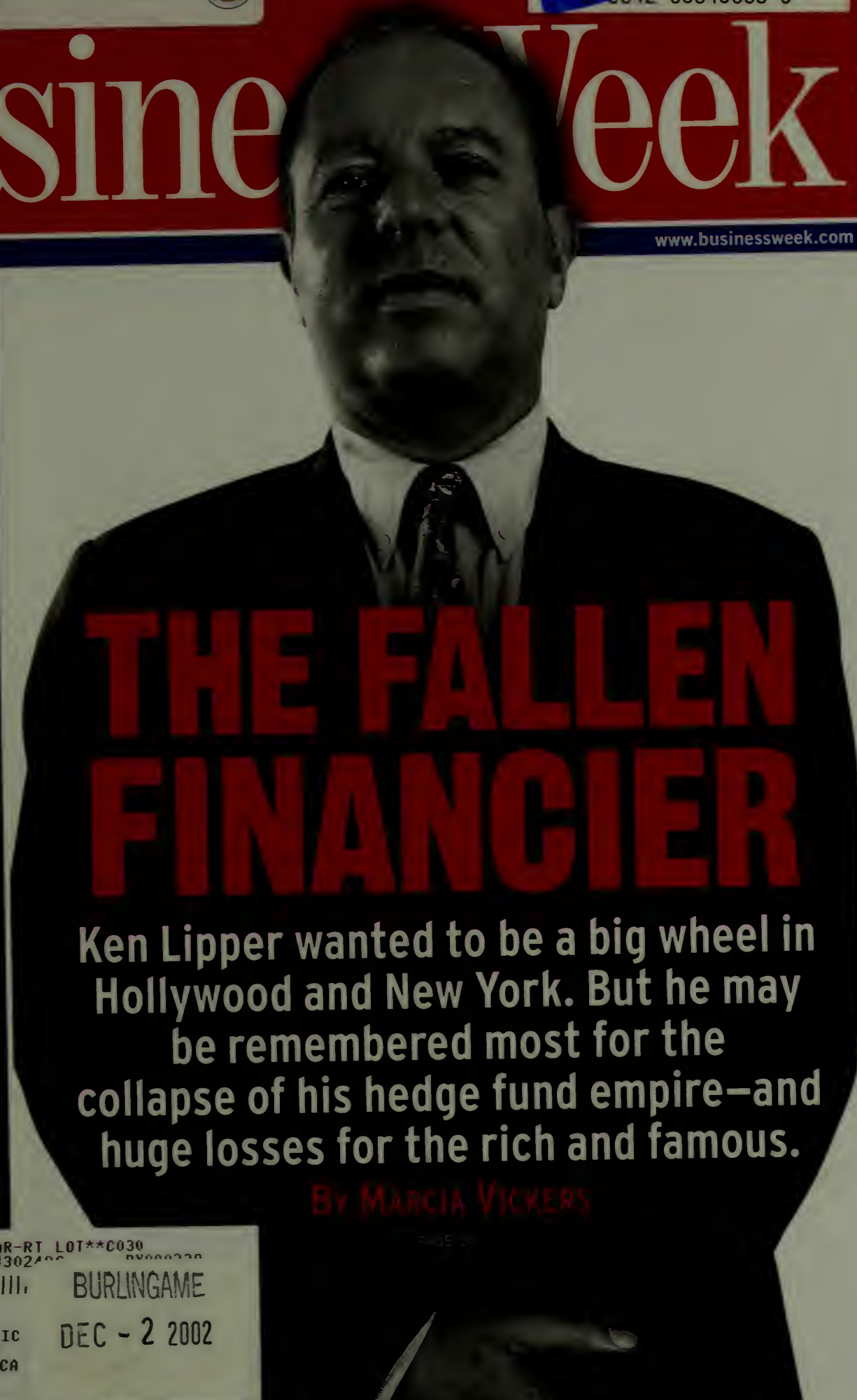
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THE FALLEN FINANCIER

Ken Lipper wanted to be a big wheel in Hollywood and New York. But he may be remembered most for the collapse of his hedge fund empire—and huge losses for the rich and famous.

By MARCIA VICKERS

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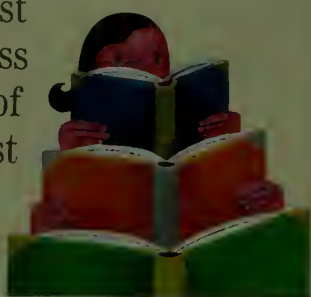
COVER STORY

FALLEN FINANCIER

Ken Lipper (right) seemed "a Renaissance man with the Midas touch." Then his world crumbled page 106

TOP 10 PICKS

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Cover Story

106 THE FALLEN FINANCIER

With his fancy connections in New York and Hollywood and vast wealth, Ken Lipper was a magnet for rich and famous investors who put their faith in his judgment. They should have looked closer. His hedge funds contained highly speculative securities and were leveraged to the hilt. When his top traders suddenly vamoosed, it became clear that the firm's losses were enormous. Now, Lipper may face lawsuits and charges of fraud that could cost him his career

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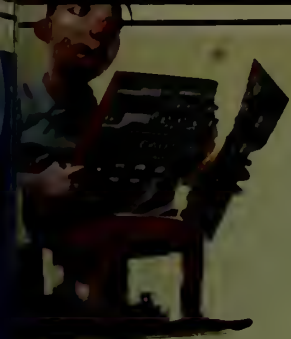
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Way back in the late nineteenth century, Jules Verne, that master of science fiction, foresaw many of the technological wonders that are commonplace today. Yet, as far-reaching as Mr. Verne's imagination was, even he would be amazed at the many marvels there are to be found in the Lexus ES 300.

He'd appreciate the available rain-sensing windshield wiper system. (Old Captain Nemo probably would too.) A special sensor employs reflected and emitted light in order to detect the presence of raindrops on the windshield.

RAIN-SENSING
WINDSHIELD WIPERS.
EVEN JULES VERNE DIDN'T SEE
THIS ONE COMING.

Not only does the system switch the wipers on and off, but it will measure the degree of precipitation and increase the wiper speed as necessary. So no matter what the driving conditions may be, from a light drizzle to a heavy downpour, you're able to give the road ahead your full, undivided attention.

This is one example of the new world of luxury that awaits you in the Lexus ES 300. A car that was built on the idea that every journey, whether it's to the center of the Earth, or the center of town, should be unforgettable.

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Up Front

EDITED BY KIMBERLY WEISUL



LEGALESE

THROW THIS BOOK— BUT DON'T SHARE IT

THE MARYLAND BAR ASSN.'S annual directory of lawyers and judges is hardly a page-turner. But considering the \$57 price tag, it's not difficult to understand why a member of the bar might want to loan the book to, say, a financially strapped nephew in law school.

Forget it, says the bar. The Maryland Bar Assn., along with hundreds of other trade groups, is shrink-wrap-

ping a contract with many of its publications. The contract is meant to be binding on anyone who breaks the plastic seal. Among its terms: No reselling, loaning, or giving away the book.

The groups are taking a page from software makers, who for years have used the gambit to discourage copying. There's just one problem: Shrink-wrapped contracts for books could be illegal. They conflict with the federal first sale doctrine, which allows the buyer of a book to resell it, burn it, or give it away. "If anybody should know better, it's the bar association," says Miriam Nisbet, an attorney with the American Library Assn.

The associations say the contracts are needed to keep their directories from being turned into mailing lists. But even they don't seem quite certain of the legality of the tactic. Says Paul Carlin, a lawyer and executive director of the Maryland Bar Assn.: "I'm getting legal counsel to look at it."

Lorraine Woellert

CLASS NOTES

YOU MEAN CHEATING IS WRONG?

COLLEGE STUDENTS ARE DISTURBED by recent corporate scandals: Some 84% believe the U.S. is having a business crisis, and 77% think CEOs should be held personally responsible for it.

But when the same students are asked about their own ethics, it's another story. Some 59% admit cheating on a test (66% of men, 54% of women). And only 19% say they would report a classmate who cheated (23% of men, but 15% of women—



even though recent whistleblowers have been women).

The survey of 1,100 students on 27 U.S. campuses was conducted by Students in Free Enterprise (SIFE), a nonprofit that teams up with corporations to teach students ethical business practices. "There's a lack of understanding about ethics and how ethics are applied in real life," says Alvin Rohrs, SIFE's CEO. "We have to get young people to stop and think about ethics and the decisions they're making." Otherwise, today's students may be tomorrow's criminals.

Jennifer Merritt

TALK SHOW "The potential windfall was probably far greater than the contents of a bank vault, and they didn't even need a getaway car. All they needed was a phone and a computer."

—FBI Assistant Director Kevin Donovan, on an identity fraud that victimized 30,000 people

SECOND ACTS

E-TAILERS MAKE GOOD ON THEIR IPOs

WHILE THE STOCK MARKETS are still a long way from the heady days of the dot-com bubble, a funny thing has happened: As of Nov 25, IPO returns on online retailers edged back into the black.



BEST-SELLER: Amazon.com shares

Since shares of eBay, Expedia, Hotels.com, and Amazon.com have surged recently, they and a few others now bail out every bad e-tail IPO put together. If you had invested \$1,000 in each of the 57 e-tail IPOs since 1997, you

would now have some \$63,500, including proceeds from companies that were sold. eBay, which was the first to go public, is now worth about \$22,700. On the flip side, the same bet on Priceline.com nets just \$12,000.

Why the runup? Profits are up. The stocks are all at least cash-flow positive, as are about two-thirds of the remaining publicly traded e-tailers. More consumers are shopping online. On Nov 22, the Commerce Dept. reported that retail spending on the Net jumped 34% in the third quarter, excluding travel and auctions.

IPO gains have long been concentrated among a few winners. Since 1980, 1% of companies that have gone public have created 82% of long-term IPO gains. A recent Morgan Stanley study says. True, e-tailers are way off their 2000 peaks. So one lesson for investors is clear: When Wall Street throws a party, come early, and just stay home.

Timothy J. Mullane

THE LIST HOT TOYS

Which toys will fly off retailers' shelves this holiday season? Only Santa knows for sure, but here are some early predictions, based on fall sales:

TOY/MAKER/PRICE	DESCRIPTION
MICROPETS Tomy, \$9	Tiny computerized toys respond to voices, sing, dance, and pout when ignored
YU-GI-OH! Upper Deck, \$12	Players face each other in three "duels" in this fantasy card game
SPIDERMAN WEB BLASTER Toy Biz, \$15	Kids can use this special glove to shoot webs like Spidey
BARBIE AS RAPUNZEL DOLL Mattel, \$20	Rapunzel Barbie's hair "grows," and her hairbrush plays music when used
BRATZ FUNK 'N' GLOW MGA Entertainment, \$30	Clothing for hipster fashion dolls is embedded with tiny blinking lights

Data: PlayDate, Toys 'R' Us, Toy Wishes



VOTED BEST BLEND.

1st place: The Famous Grouse

2nd place: Pigs Nose

3rd place: Ballantine

4th place: Dewar's, Johnnie Walker Red

5th place: Cutty Sark

6th place: J&B

Recently, *Quarterly Review of Wines* asked its Spirits Tasting Team to round up Scotland's best and most readily available blended whiskies for a blind taste comparison. The results were truly revealing. Given points for color, bouquet, taste and finish, The Famous Grouse surpassed all of America's most popular blends. This comes as no surprise to the Scots. We're just glad to be noticed.



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Up Front

CAR TALK

SUV HATERS OF THE WORLD, UNITE

ENVIRONMENTALISTS AND safety hawks have long griped that sport-utility vehicles waste gas, crowd highways, and endanger motorists.

Now, with the geopolitics of oil much in the news, SUV-bashing is mounting.

"A growing number of consumers are jumping on the anti-SUV bandwagon," says analyst Wes Brown of researchers Nextrend. However, he doesn't expect to see a wave of trade-

ROAD HOG: ins anytime *And guzzler* soon. "We are probably at the fringe of some people recognizing that an SUV [isn't]

the best thing to own."

So when syndicated columnist Arianna Huffington wrote on Oct. 22 that money spent fueling SUVs indirectly funds terrorism, she received so much support that she set up a fund for an anti-SUV ad campaign. She raised \$35,000 in a month. Now, with *Pulp Fiction* producer Lawrence Bender, she's trying to get money for airtime. German auto maker BMW already runs anti-SUV ads, likening the vehicles to dinosaurs while touting its Mini Cooper.

A more broad-based push against SUVs comes from the Interfaith Coalition for the Environment, a group of Christian and Jewish clergy. Claiming 150,000 congregations as members, the group's leaders took hybrid Toyota Priuses to Detroit on Nov. 20 to urge the Big Three to make more environmentally responsible cars.

Still, it won't be easy: Last year, sales of light trucks topped those of cars for the first time. *David Welch*

LOST & FOUND

WHEN CELL PHONES GO ASTRAY

CELL PHONES—SUPPOSEDLY the lifelines of the mobile crowd—are going the way of umbrellas and sunglasses. They're easily lost, and few bother to reclaim them.

More than 400,000 passengers move through New York's historic Grand Central Terminal each day, and an awful lot of them leave their phones behind. Every year, 3,000 handsets are turned in to the station's lost and found, says manager Mike Nolan. There might be hundreds of phones in his office at any one time. "We do our best to

get them back to their owners," he says, mostly by dialing numbers in the phones' directories. About 60% of the devices are returned within the 90 days state law says Nolan must hold on to them.

Each month, 100 phones go unclaimed—probably because a third of users get their phones free of charge, and 80% pay less than \$100, says Yankee Group's Roger Entner. "Cell phones have become throwaway items, almost."

Eventually, abandoned phones are donated to a charity that reprograms them to call 911 and gives them to victims of domestic abuse—where the phones may save a life, instead of annoying fellow commuters.

Robert McNatt

DRAWN & QUARTERED



I-WAY PATROL

TAKING A BITE OUT OF SPAM

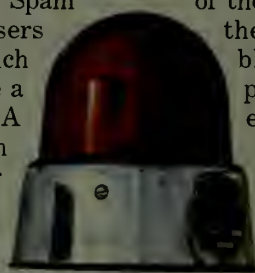
WANT TO CUT SPAM BY 20%? A new feature of AOL's version 8.0 may allow you to do just that. AOL's Report Spam button gives users something to punch every time they see a pesky cybergram. A pop-up window then promises the user that all future e-mail from that address will be blocked. AOL has long enabled users to report spam, but this is the first time it has provided a one-click solution.

The button does seem to provide more than mere psychological relief, even though spammers constantly change

their e-mail addresses. AOL says the reports have increased tenfold to about a million a day since the button appeared in mid-October. That has helped cut spam on its network by 20%. On Nov. 11, for example, after ten thousand clicks on the button, AOL blocked mail from porn site superhotemail.com, set up five days earlier in Athens, Greece.

Rival MSN says it uses filters to keep out spam, and scoffs at AOL's button. "It's 'technologically unsophisticated,'" says MSN product manager Larry Grothaus.

The button may not wipe out spam, but it certainly can curtail the worst offenders—while giving users a chance to vent. *Catherine Yang*

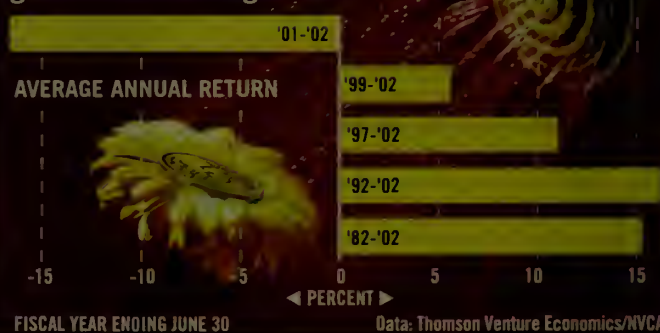


POLICING: Easier

THE BIG PICTURE

WILTING VENTURE CAPITAL RETURNS

The tech wreck clobbered this year's venture capital gains, but they're still good when the longer view is taken:



FISCAL YEAR ENDING JUNE 30

Data: Thomson Venture Economics/NVCA

Polls, surveys, and

other items for this section should be sent to upfront@businessweek.com

WE PROMISE TO EXPLAIN THE WONDERS OF OUR SYSTEM-ON-CHIP RESEARCH
AND HOW SCOTLAND IS SHAPING THE FUTURE OF ELECTRONIC DESIGN.

BUT FIRST WE NEED TO GET PAST THE KILT THING.



roots of the
design can
traced all the
back to the
Roman toga.

Modern kilts can
be used as a
cloak, camouflage,
a satchel bag or
a sleeping bag.

Kilts were never
popular outside of
their originating
highlands, where
they were
expensive and rare.
This is because
they are impractical
for riding.

The reality is you'll find more Scots donning lab coats than kilts these days.

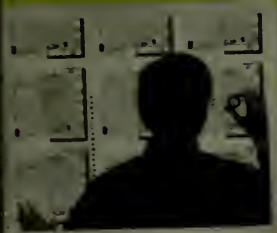
In electronic design, our innovative Alba Centre is leading the world's R&D in System Level Integration technology, as well as promoting enormously successful collaborations between top universities and private sector partners. And of course, there's Dolly, our now famous sheep who became the first mammal cloned from an adult cell—a direct result of Scotland's thriving and inventive biotech industry.

Today, the question progressive companies are asking us has little to do with matters such as why we wear kilts—and has everything to do with how to gain access to the kind of vast knowledge base Scotland offers.

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JUST HOW GOOD WAS GERSTNER AT IBM?

Louis V. Gerstner Jr., in his nine years at IBM, forced out thousands of loyal employees with layoffs and forced retirement in their late 40s and 50s. ("Lou takes the gloves off," Information Technology, Nov. 18). The object was not to "save the company." IBM has thousands of large corporations throughout the world using operating systems and hardware developed over many decades that is difficult or nearly impossible to replace, and IBM averages \$14 billion in profits every year.

Gerstner used \$43 billion from profits to boost the share price at IBM with stock buybacks in his nine years at IBM, used the \$17 billion in the "old money" pension surplus to boost the annual profits by 20% with "vapor profits" that boosted the share price of IBM stock. This same pension surplus is now less than \$500 million today. Meanwhile, retirees received one cost-of-living adjustment in 10 years, the same year IBM did away with promised medical coverage for retirees.

Rather than rescuing a company in trouble, how about an "accounting illusion" to effect radical change? This is my opinion as an employee who worked at IBM for 32 years and fell victim to Gerstner's methods of wealth accumulation at the expense of a once most-admired company.

Mike Saville
Riverton, Utah

Lou Gerstner says with pride that he never cut research and development. He understood that the "p" in p-e ratio most times means the "present value of the future stream of earnings" for the company, and that research and development produces most of those fu-

ture earnings streams. Most Wall Street analysts should take a lesson from Gerstner. In times of trouble, reducing R&D as a short-term earnings strategy lowers those future streams. CEOs who expediently reduce R&D expenditures to meet analysts' or the Street's short-term earnings demands should have their company's p-e lowered for not thinking strategically. Few analysts understand the negative earnings effect of lowered R&D expense. Gerstner proved that "short-term earnings" should not be the sole criterion for company performance. Companies that maintain or increase R&D during difficult times should be rewarded for their vision.

Alan B. Shalle
Princeton, N.J.

'ON-DEMAND' COMPUTING: BEEN THERE, TRIED THAT

Could it be Yogi Berra's "déjà vu all over again" with IBM pushing "on-demand computing?" ("Computing power sold like electricity," News: Analysis & Commentary, Nov. 11). In the late 1960s, IBM's Data Services Div. tried a similar concept, where customers leased from us the computing power of our IBM 360 computers. It was called "time-sharing" and its time was short-lived.

Kenmore R. McMane
Laguna Woods, Calif.

COMPLAINTS OF A FORMER COMCAST CUSTOMER

I read with interest the piece on Brian L. Roberts and Comcast Corp. ("A new cable giant," Cover Story, Nov. 18). I was excited when Comcast took over our service in June, 2001. I heard great things about Comcast and looked forward to new services like high-speed Internet. That all changed quickly. Prices

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Readers Report

went up two times in a 12-month span. Channels were cut. Twice, attempts to contact the local Comcast representatives were ignored. It became apparent that the changes were thinly disguised attempts to force people off analog service to the new digital side. DISH Network and their 50-channel package appeared at a fair price, and we switched. I went from a potential \$100-a-month user of Comcast services to zero in 12 months.

Greg Young
Womelsdorf, Pa.

VERIZON DEFENDS ITS RETIREMENT BENEFITS

Verizon Communications Inc. is proud of its retirees and recognizes their contributions to the company. ("Revenge of the retirees," Working Life, Nov. 18). At a time when other companies are cutting benefits, Verizon retirees receive a pension, 401(k), and medical and life insurance benefits. In 2001, the company paid \$3.9 billion in pension benefits and \$990 million in medical and life insurance to 200,000 retirees. During the past five years, Verizon also made special lump-sum pension payments or increased pensions for tens of thousands of retirees, including members of the Association of BellTel Retirees. Today, our retirement benefits are among the very best in Corporate America, and we intend to keep them that way.

Ezra Singer
Executive Vice-President
for Human Resources
Verizon Communications
New York

THE MERGER FUND IS STILL AN EXCELLENT HEDGE

We do not dispute that The Merger Fund has been "bruised" by certain of its bond investments this year ("Bruised by bonds," Dividends, BusinessWeek Investor, Nov. 25). Our losses occurred months ago, however, and we fully informed our shareholders at the time. Since then, our bond portfolio has actually shown a substantial recovery. Perhaps "Buoyed by bonds" would make a good title for your next story about us.

What we do take exception to is the last paragraph of the piece. Had your reporter invested the time to interview a random sample of financial planners and investment advisers who have put clients into The Merger Fund in recent years, I guarantee he would have found that the vast majority believe that the fund has been an excellent hedge during

the bear market and continues to be a great diversification tool.

Frederick W. Green
President
The Merger Fund
Valhalla, N.Y.

NUCLEAR POWER: CATASTROPHE AND FUTURE SAFETY

"Why atomic energy burns brighter than ever" (Industry Insider, Nov. 18, in some editions) implies that a "catastrophic meltdown" at Three Mile Island Reactor Unit 2 was avoided. Even though a massive containment breach was avoided, it most certainly was a meltdown (a third of the core slumped), and the event was definitely an economic catastrophe. Also, Framatome's Tom Christopher says that if you stack up all the U.S. spent fuel rods, "you'll have a pile that's 10 yards high and fits inside a football field." Of course, Christopher knows such a dense pile is impossible, for reasons of inadequate thermal dissipation. But give him credit for not repeating the industry's reckless claim of two decades ago that the pile would fit into a tennis court.

Kerry Tatlow
Rockford, Ill.

If the federal government continues to buy the argument that nuclear power plants are safe, secure, and needed, shouldn't federal legislation be changed to provide for homeowner insurance? Homeowner insurance policies do not cover losses caused directly or indirectly by nuclear accidents. The entire nuclear power industry is only insured for \$9.3 billion.

Paul Feiner, Town Supervisor
Greenburgh, N.Y.

BARRO SHOULDN'T CONFUSE ECONOMICS WITH REAL LIFE

Robert Barro is amused over U.S. Attorney General Eliot Spitzer's attacks on the quality of stock-picking by Salomon Smith Barney's Jack Grubman ("Bush's economic policies: The bull's-eyes and busts," Economic Viewpoint, Nov. 4), saying that "economists" find zero value in these kinds of stock recommendations. Analysts and their employers did not disseminate those recommendations primarily to influence economists' stock purchases. The reality is that these recommendations widely influenced many individual investors, and even some large institutional investors—as they were intended to do. I find Barro's take in this whole sorry

situation silly if not disingenuous, certainly of about zero value.

Robert W. Gu
Black Mountain, N.C.

Barro proposes revising the antitrust laws to permit mergers in concentrated industries with "overcapacity," including the rejected 1999-2000 purchase of Sprint by MCI WorldCom. Unprofitable investment decisions do not justify creating monopolies. Antitrust laws already permit mergers for businesses that would otherwise go bankrupt. Financially sound Sprint is probably now free to purchase bankrupt WorldCom at fire sale prices. Unfortunately, WorldCom's dishonest accounting means that no company dares to purchase it for fear of large and unknown liabilities.

Carl Lundgren
Economist and President
Relpromax Antitrust Inc.
Arlington, Va.

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A BOFFO YEAR FOR BUSINESS BOOKS

Wealth, influence, and politics are dominant chords in several of the top 10 business books of 2002 selected by *BusinessWeek* reviewers. Nowhere are the themes woven together more provocatively than in Kevin Phillips' *Wealth and Democracy: A Political History of the American Rich* (Broadway Books). This volume presents the same basic argument as the political commentator's 1990 book, *The Politics of Rich and Poor*. The wealthy use their money to buy influence and then employ their resulting influence to accumulate more money. This time, the argument is placed in a broad historical context. Today, says the author, we are at the end of a third great historical cycle in which egalitarian policies get replaced "conclusively by the language of Wall Street, Darwinism, and tax-cut worship." Each time, the result has been a greater concentration of wealth and power at the top. However, the author cautions, more than once the superrich have gotten a comeuppance in the form of stock-market crashes that accompany the wealth-accumulation cycles. Reviewer Paul Magnusson found that "*Wealth and Democracy* is enough to make any but the most privileged Americans deeply suspicious about the growing influence of the wealthy on their government."

The rich come off better in *Tuxedo Park: A Wall Street Tycoon and the Secret Palace of Science That Changed the Course of World War II* (Simon & Schuster) by Jennet Conant, a former *Newsweek* and *Vanity Fair* writer. This is the story of magnate and self-taught physicist Alfred Lee Loomis, who in the late 1920s installed a state-of-the-art physics lab at his sprawling Tuxedo Park, N.Y., estate and hosted such notables as Albert Einstein, Niels Bohr, and Enrico Fermi. Later, at the outbreak of World War II, Loomis played a key role in winning support for research in radar technology that proved essential to Allied victory. Reviewer Otis Port said Conant's account would be of interest to fans of World War II history, adding that "it will captivate students of science and technology."

The name Rockefeller is synonymous with privilege. David Rockefeller provides readers with an inside look at both his life and the postwar American Establishment in *Memoirs* (Random House), which reviewer Bob Dowling called a "revealing, forthright account." After his student years and service in the army during World War II, Rockefeller, at age 30, took a job at Chase Manhattan Bank, where his maternal uncle Winthrop Aldrich was chairman. It took David 23 years to become chairman, at which point he greatly expanded the bank's international presence. But he hardly limited his efforts to business. He carried missives for Presidents and negotiated with potentates. Indeed, some thought Rockefeller took on too much—with the result that in the early 1970s, Chase landed on the Comptroller of the Currency's problem-bank list. But once Rockefeller focused on the difficulties, he was able to turn things around in just four years.

Wall Street power is the subject of *Take on the Street: What Wall Street and Corporate America Don't Want You to Know; What You Can Do to Fight Back* (Pantheon) by former Securities & Exchange Commission Chairman Arthur J. Levitt, with *BusinessWeek*'s Paula Dwyer. In addition to offering advice on how to invest wisely, Levitt describes his term, which ran from 1993 to 2001, and his efforts to overcome the "unholy alliance" among corporations, stock analysts, and powerful institutional investors. In particular, Levitt describes how he took on the accounting industry over the way it allowed corporations to mislead investors on earnings. As he shows, the industry hardly took this lying down, enlisting allies from both parties and leading corporate executives to



Our Top 10*

CREATING A LIFE

by Sylvia Ann Hewlett

dot.con

by John Cassidy

GLOBALIZATION AND ITS DISCONTENTS

by Joseph E. Stiglitz

MARTHA INC.

by Christopher Byron

MEMOIRS

by David Rockefeller

TAKE ON THE STREET

by Arthur Levitt with Paula Dwyer

TUXEDO PARK

by Jennet Conant

WEALTH AND DEMOCRACY

by Kevin Phillips

WHAT MANAGEMENT IS

by Joan Magretta with Nan Stone

WHO SAYS ELEPHANTS CAN'T DANCE?

by Louis V. Gerstner Jr.

*In alphabetical order by title

pose reforms. In the end, Levitt got out half of what he was seeking—he wanted to ban consulting by auditors, for example, but ended up banning only certain kinds of consulting. A year after Levitt left office, the corporate scandals involving Enron, WorldCom, and others broke—and Congress hurriedly passed legislation providing just about everything Levitt wanted in the first place.

Speaking of scandals, does Martha Stewart know how to keep her name before the public or what? For a striking portrait of the domestic diva, check out *Martha Inc.: The Incredible Story of Martha Stewart Living Omnimedia* (Wiley) by journalist Christopher Byron. The book was published before Stewart's insider-trading scandal erupted, and therefore can't provide the details that many readers crave. Nonetheless, it colorfully chronicles Stewart's rise and rapid ascent following the publication of her book *Entertaining* in 1982. Although Byron clearly admires Stewart's ability to turn herself into a multimillion-dollar brand, he revels in flattering anecdotes from such sources as her former catering partner, ex-colleagues from Kmart Corp., and the tour guides, neighbors, and journalists she has alienated. It's not exactly a balanced portrait since those who might feel more positively about Stewart, such as business partner Sharon Patrick—not to mention Stewart herself—did not grant interviews to the author. Byron's best moments come when he examines the business, underscoring the difficulty of maintaining any operation built around one human being. "It makes for a fascinating, if clearly lopsided, read," said reviewer Diane Brady.

Those bruised by the tech-stock roller coaster can revisit the experience in *dot.con: The Greatest Story Ever Sold* (HarperCollins) by John Cassidy, a *New Yorker* staff writer. The volume excels at addressing such questions as why professional money managers continued to pour funds into the stocks of Internet companies that had no profits and no prospects. They had to follow the herd, Cassidy says, sticking close to the Standard & Poor's 500-stock index to protect their jobs. There's plenty of blame for the

Passionate takes on executive women, Wall Street, rich men's lives, smart managing, globalization, and democracy itself

debacle to spread around, but the author says Alan Greenspan must get a portion. The Federal Reserve chairman, he says, failed to raise interest rates soon enough to prick the stock bubble and then didn't ease soon enough after the market cracked in early 2000.

In *Globalization and Its Discontents* (Norton), Nobel prize-winning economist Joseph E. Stiglitz argues that global financial institutions aren't helping many poor countries. Incomes are not rising in much of the world, and adoption of market-based policies, such as open capital markets, free trade, and privatization, are making developing economies less stable, not more so. The author faults the International Monetary Fund's requirements of fiscal austerity and market liberalization, arguing that China and Korea have succeeded precisely because they have not followed such dictates. When a developing country faces a financial crisis, Stiglitz says it should keep interest rates low and keep credit flowing—the opposite of what the IMF would want. Reviewer Michael J. Mandel says this volume could "give additional weight to a new conception of globalization."

According to reviewer Catherine Arnst, "a nuanced picture of what life is like in the U.S. for career women" can be found in economist Sylvia Ann Hewlett's *Creating a Life: Professional Women and the Quest for Children* (Talk Miramax). The heart of the book is a national survey of professional women and high-achieving men. Out of this came the headline-grabbing finding that 49% of women over 40 who earn more than \$100,000 a year are childless—compared with only 19% of men in the same category. Since only 14% of these women said that they had not wanted



children, it isn't as though they were making a conscious choice of job over family. Instead, many simply never found spouses, perhaps because "successful men are not interested in acquiring a peer as a partner," in the words of one woman interviewed by Hewlett. The author also devotes a heartbreaking chapter to the problem of infertility and describes the clash between demanding corporate work and family life.

It was a strong year for management books. One of the best was *What Management Is: How It Works and Why It's Everyone's Business* (Free Press) by Joan Magretta with Nan Stone, both formerly of *Harvard Business Review*. "Rarely has anyone so succinctly and engagingly presented the core principles of managing in a single book," said reviewer John Byrne. The slim volume takes readers on a relatively jargon-free journey through the ideas of some of the world's greatest management savants, from Peter Drucker to Michael Porter. We visit a wide range of successful companies, from eBay Inc. to Toyota Motor Co. And the authors provide perceptive takes on getting the most from employees—the best of whom they say must "know enough and care enough to manage themselves." There is no one best way to organize, they say: Scale, scope, and structure all depend on what an organization is trying to accomplish.

Similarly down-to-earth is Louis V. Gerstner Jr.'s *Who Says Elephants Can't Dance? Inside IBM's Historic Turnaround* (HarperBusiness). "This is not my autobiography," the ex-CEO announces early on. Gerstner devotes little space to his youth and career prior to Big Blue, the company into which he "parachuted" on Apr. 1, 1993. IBM was then in big trouble, with \$8 billion in losses and 73,000 slashed jobs. Gerstner found an ossified culture that included "a general disinterest in customer needs," "a preoccupation with internal politics," and a "general permission to stop projects dead in their tracks." Reviewer Ira Sager found the material on IBM's culture to be "a must-read for any student interested in strategy, corporate behavior, or even simply how to communicate with employees." One caveat: Gerstner doesn't respond to critics who say his turnaround was largely the result of ledger-book maneuvers. But for its fly-on-the-wall detail of life at IBM, the volume still warrants close attention.

COMPILED BY HARDY GREEN
Green is Books Editor.

BY STEPHEN H. WILDSTROM

tech&you@businessweek.com

A BIG HAND FOR TWO NEW PALMS



One is fast and ultralight; the other comes stuffed with multimedia goodies. Both are winners

The leading edge of a new generation of Palm handhelds has arrived, and the first two products—the Tungsten T from Palm Solutions and the Clie PEG-NX70V from Sony Electronics—could hardly be more different from each other. Both run the new OS 5 system software from PalmSource, and both offer the contact list and calendar that have always defined Palms. But the Tungsten, tiny enough to slip into a shirt pocket, is a power tool for the mobile executive, while the Clie is built for fun, taking Sony's passion for multimedia handhelds to a new level.

At first glance, the \$499 Tungsten seems to have neither a keyboard nor a way to enter Graffiti—a simplified way of writing the alphabet that software can easily turn into text. The secret is that the bottom inch or so of the case, which carries the four familiar Palm buttons plus a new four-way navigation pad, slides down to reveal a Graffiti entry area. Closed, the Tungsten is just 4 in. by 3 in. and weighs just 5.6 oz.

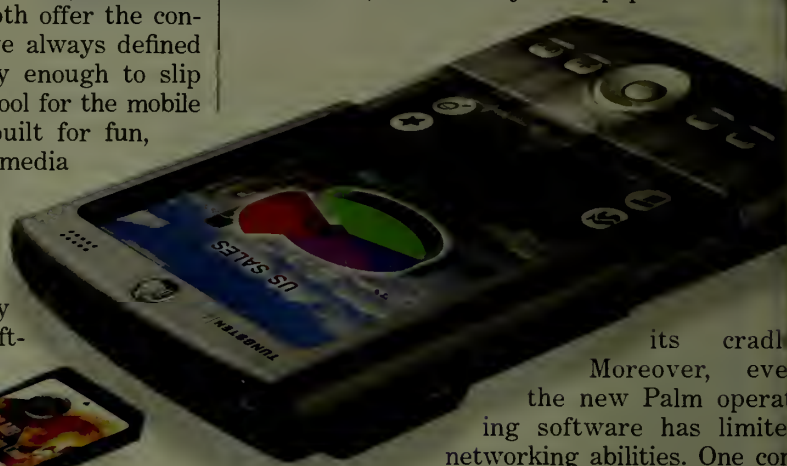
When open, the Tungsten strongly resembles the Palm m515, which it replaces, in both form and function. A new Texas Instruments processor makes performance a lot zippier, and the screen resolution has quadrupled to 320 pixels by 320 pixels. Storage can be expanded beyond the basic 16 megabytes with SD memory cards. There's a real sound system, including a microphone and a stereo-headphone jack. But to use it as a music player, you'll have to download software from Real Networks.

The other big hardware change—built-in Bluetooth short-range wireless communications—falls well short of its potential, at least for now. In theory, you could sync your data wirelessly with a Bluetooth-equipped PC, but in practice, it's very difficult to set up and will stay that way until Microsoft adds Bluetooth support to Windows next year. (It's a bit easier on a Macintosh.) You can use the Tungsten with a Bluetooth phone to connect to the Internet, but the unit lacks a decent mail program and Web browsing is no fun on that tiny screen. If you want a phone-Palm combo, get a Handspring Treo.

If the Tungsten evinces elegant minimalism,

the \$599 Clie goes for a multimedia extravaganza. Like previous Clies, the big handheld—in. long when closed and weighing 8 oz.—uses flip-open design with a camera built into the hinge. (A model with no camera costs \$100 less.) Opening the Clie reveals the basic Palm buttons and a keyboard that offers an alternative using Graffiti. The display also swivels, so the unit can fold into a tablet or stand, tepee-style, show pictures or video on the screen.

The Clie features a slot for a WiFi wireless networking card (\$150). It lets you browse the Net or fetch e-mail, but the Clie's excellent screen is still too small for efficient Web-page viewing, and the Clie Mail program isn't very good. You can do a wireless HotSync, but that will probably work only within your local network. It's less trouble just to pop the Clie into



TUNGSTEN T

The bottom of the case slides down to reveal an entry pad

its cradle. Moreover, even the new Palm operating software has limited networking abilities. One consequence: It is almost impossible to diagnose common wireless-networking problems.

Clies have always specialized in rich content—playing music and movies, running slide shows, and doing other things that we supposed were impossible on a Palm-based handheld before OS 5. One handicap that even Sony's clever engineers couldn't overcome in the older models was a very slow processor. The new version boasts a speedy Intel XScale chip that makes it a pleasure to play MPEG or Macromedia Flash movies, listen to songs, view pictures, and even do a little light photoediting. Sony supplies a vast range of software to take advantage of these features and a MemoryStick slot for the expansion memory you'll want to run them. To manage the applications, Sony scrapped Palm's static display of icons in favor of a Start menu-like list of programs that you can scroll through and select with a jog wheel on the left side. The new approach takes a bit of getting used to, but it works well for the sort of long program list you are likely to have on a Clie.

If you want a high-end handheld that's all business and that you can carry almost without being aware that you have it with you, the Tungsten is just the thing. But if you prefer the biggest, brassiest, and most fun Palm device ever, go for Sony.

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BY ROBERT J. BARRO

THE BEST LITTLE MONOPOLY IN AMERICA



CARTEL CONTEST:
The contenders include the Post Office, Microsoft, and the NCAA. And the winner is...

Every now and then, I run a contest to choose the best monopoly operating in America. This time, the finalists, chosen by a panel of Harvard University economists, are: The U.S. Postal Service, OPEC, Microsoft Corp., the International Longshore & Warehouse Union (ILWU), and the National Collegiate Athletic Assn. (NCAA). Others who just missed the cut are Major League Baseball, the National Education Assn. (NEA), and the Massachusetts Democratic Party.

The U.S. Postal Service has the longest history of monopoly power in the country and has the distinction of being mentioned in the U.S. Constitution. In the past, the post office was impressive in using its monopoly to maintain high wages despite a widespread reputation for poor service. But these past accomplishments have been severely compromised by its inability to control the entry of competitors. First came FedEx Corp. and its clones, then the fax machine, and then, most destructively, the Internet and e-mail. The failure to get Congress to classify all these innovations as first-class mail and therefore the exclusive domain of the Postal Service demonstrates a tremendous loss of muscle. Therefore, this contestant fails to measure up and should probably not even be nominated in the future.

The glory days for OPEC were from the first oil crisis in 1973 through the early 1980s. Led by our friends, Saudi Arabia and Kuwait, OPEC was able to hold down production and thereby create high oil prices, soaring profits, and recession in the West. Since then, things have become more difficult for the cartel. OPEC now controls less than one-third of world oil production, and some unruly members, such as Libya and Iran, are always trying too hard to produce. The U.S. has helped the monopoly via environmental restrictions on domestic production, limiting sales from Iraq, and embracing the Saudis and Kuwaitis. Nevertheless, OPEC's power has declined, and high oil prices emerge only intermittently, at times of world crises. One panelist also complained that, despite its implicit collusion with the U.S., OPEC is not American and should be disqualified. Therefore, it is hard to see how OPEC can ever win this contest.

Microsoft is a dangerous monopolist, according to the U.S. Justice Dept. Probably the biggest problem with this argument is that the Redmond (Wash.) company attained its dominant position in operating systems and software by providing low-priced, innovative products that

consumers valued. In fact, the main point of the recent antitrust case (and of the case against IBM years before) seemed to be to provide substantial fees for numerous lawyers and economists. The recent court-approved settlement agreed that no aggressive remedy was warranted. Given this, how can Microsoft be America's best monopoly?

A more serious candidate is ILWU, the West Coast longshoremen's union. Here we have a group of about 10,000 semiskilled workers who have used their monopoly position to push up their annual salaries to more than \$100,000 and have the muscle to damage the entire U.S. economy. The union has excelled at limiting the introduction of productivity-enhancing technologies that would likely compromise its monopoly power. In the heyday of antitrust enforcement in the 1890s under the Sherman Antitrust Act, the ILWU would have been declared illegal as a "conspiracy in restraint of trade." But later legislation effectively exempted labor unions from antitrust laws. Thus, the ILWU's only restraints seem to be the ongoing injunction against their strike that President George W. Bush imposed under the Taft-Hartley Act and the possibility that the Bush Administration would eventually send in troops to run the West Coast ports on the grounds of national security. Perhaps these pressures account for the recent apparent settlement between ILWU and the shipping companies. This is good for the country's economy but bad for the union's claim to be the country's best monopoly.

Finally, we come to the NCAA, which has successfully suppressed financial competition in college sports. The NCAA is impressive partly because its limitations on scholarships and other payments to athletes boost the profitability of college sports programs. But even more impressive is the NCAA's ability to maintain the moral high ground. For example, many college basketball players come from poor families and are not sufficiently talented to make it to the National Basketball Assn. Absent the NCAA, such a student would be able to amass significant cash during a college career. With the NCAA in charge, this student remains poor. Nevertheless, the athletic association has managed to convince most people that the evildoers are the schools that violate the rules by attempting to pay athletes rather than the cartel enforcers who keep the student-athletes from getting paid. So given this great balancing act, the NCAA is the clear choice for best monopoly in America.

Robert J. Barro is a professor of economics at Harvard University and a senior fellow of the Hoover Institution (rjbweek@harvard.edu).

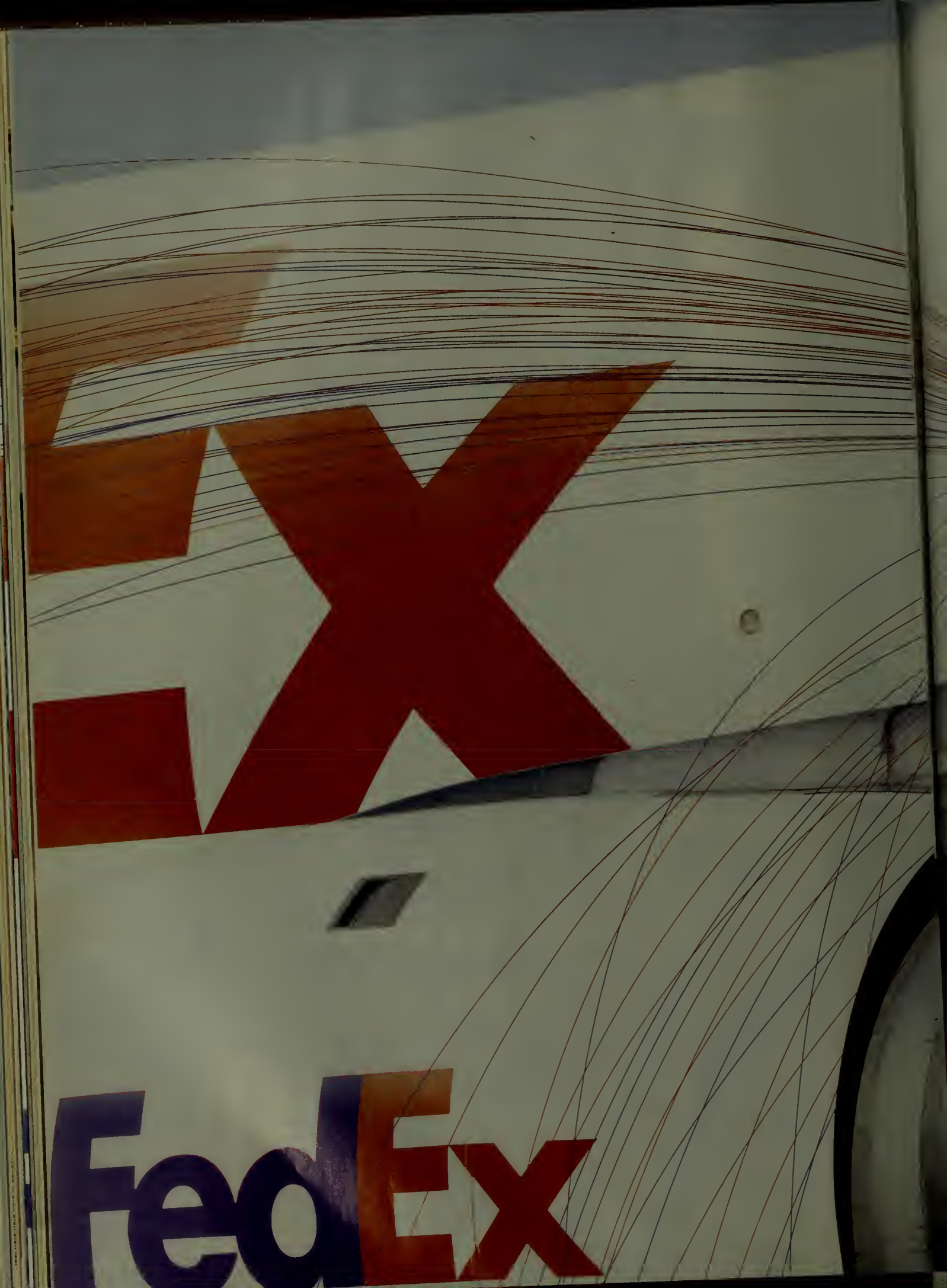
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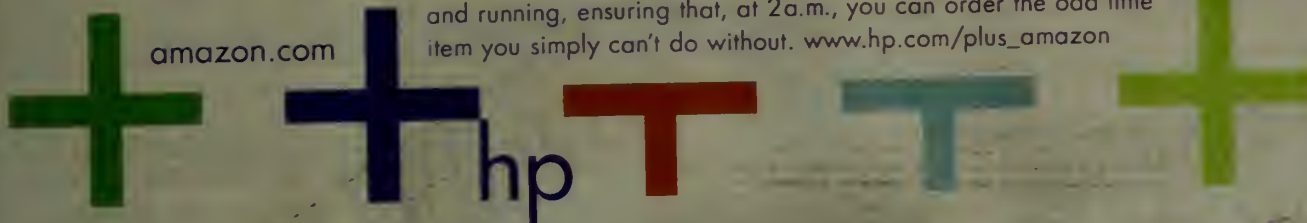
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BY GENE KORETZ

ARE WOMEN LESS COMPETITIVE?

Studies uncover a striking pattern

Although women have made huge strides in catching up with men in the workplace, a gender gap persists both in wages and levels of advancement. Commonly cited explanations for this gap range from charges of sex discrimination to claims that women are more sensitive than men to work-family



LET'S RACE: Boys' speeds went up

conflicts and thus less inclined to make sacrifices for their careers.

Now, however, two new studies by economists Uri Gneezy of the University of Chicago and Aldo Rustichini of the University of Minnesota suggest that another factor may be at work: a deeply ingrained difference in the way men and women react to competition that manifests itself even at an early age.

The first study focused on short races run by some 140 9- and 10-year-old boys and girls in a physical education class. At that age, there was no significant difference between the average speeds of boys and girls when each child ran the course alone. But when pairs of children with similar initial speeds ran the race again, things changed. Boys' speeds increased appreciably when running against either a boy or a girl, but more so when paired with a girl. Girls showed no increase when running against a boy, and even ran a bit more slowly when paired with a girl.

The second study, by Gneezy, Rustichini, and Muriel Niederle of Stanford University, involved several hundred students at an elite Israeli technical university. Groups of six students were paid to solve simple maze problems on a computer. In some groups, subjects were paid 50¢ for each problem they solved during the experiment. In others,

only the person solving the most problems got rewarded—but at the rate of \$3 for each maze solved.

Regardless of the sexual makeup of the groups, men and women, on average, did equally well when students were paid for their own performance. But when only the top student was paid, average male performance rose sharply—by about 50%—while female performance remained the same.

The authors conclude that females tend to be far less responsive to competition than males—a tendency with important implications for women and business. It may hurt women in highly competitive labor markets, for example, and hamper efficient job placement—especially for positions in which competitiveness is not a useful trait.

That's something companies with highly competitive atmospheres may need to consider, says Rustichini. If they don't, the results could be "both a subtle bias against women and, in many cases, foregone worker productivity."

NARROWING THE DIGITAL DIVIDE

A mixed report on school subsidies

In 1998, the federal government launched an ambitious program to narrow the so-called digital divide between poor and middle-class households. To promote computer and Internet use by disadvantaged students, it offered subsidies of up to \$2.2 billion a year to public schools for Web and related communications technology.

Are the subsidies, which range from 20% for affluent schools to 90% for the poorest, succeeding? In a new study based on California data, University of Chicago economists Austan Goolsbee and Jonathan Guryan respond with a qualified "yes." Fears that much of the money would go to richer schools, which would use the extra cash to replace Internet spending already under way, proved unfounded, they report.

It turns out that poor schools with mostly black and Hispanic students got the lion's share of \$937 million dispensed to California from 1998 to 2000, and their access to the Web rose so rapidly that by 2000 some boasted more Internet-connected classrooms per teacher than rich schools. The authors estimate that California had 66% more Internet-connected classrooms in 2000 than it would have had without subsidies.

Less reassuring is the researchers'

evaluation of the impact on classroom performance. Using math, reading, science test scores, they find no evidence that the Internet investment improved student achievement.

The caveat is that the expansion of Web usage in poor schools is very recent and many teachers still feel uncomfortable using computers. Over time, Web access may yet prove effective in enhancing student learning.

A STRESS TEST FOR THE DOLLAR

War may hurt it—and Wall Street

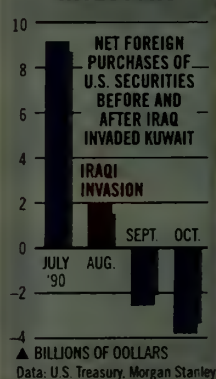
Don't be surprised if the dollar loses a lot more steam. Although its recent weakness has been attributed to a gap between U.S. and European interest rates, Joseph Quinlan of Morgan Stanley thinks it also reflects the looming threat of a war with Iraq.

He points out that Iraq's invasion of Kuwait in August, 1990, helped trigger a six-month, \$10.5 billion sell-off of U.S. equities by anxious foreign investors. Indeed, foreign net purchases of all U.S. securities, including corporate debt and Treasuries, swung from \$9.2 billion in July to a decline of \$3.9 billion in October. Over the same period, the dollar dropped 7% against major currencies.

Foreigners sold more U.S. equities and bonds when the Persian Gulf War began in January, 1991, though they did seek shelter in Treasuries. The dollar hit a low point in February. But after ceasefire on Feb. 28, foreign interest in U.S. stocks and bonds revived, and the dollar rose 5% in March, bringing it back to its August, 1990, level.

Quinlan notes that America's current account deficit is nearly 5% of gross domestic product today, vs. just 1.9% in 1990. And foreign holdings of U.S. securities are now far higher. Further, even a quick military victory in Iraq would be likely to entail a long-term U.S. presence there. Thus, he says, the impact of a war on the dollar and the U.S. stock and bond markets could be sharper and more prolonged than many experts expect.

WAR SCARES INVESTORS



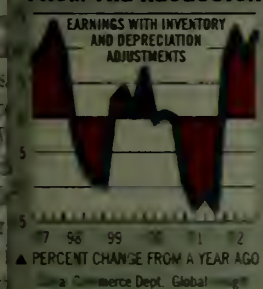
THE SOFT PATCH IS GIVING WAY TO SOLID GROUND

Gains in corporate profits and real household income bode well for 2003

U.S. ECONOMY Has the soft spot run its course? It's starting to look that way. Layoffs are ebbing. Consumer confidence is turning up. The stock market rally is holding. And a few regional surveys show that industrial activity is turning up. What's more, the Commerce Dept. says that third-quarter growth was much stronger than its first estimate and that corporate profits were up from year-earlier levels.

It's beginning to look like the fourth quarter's weakness was front-loaded, with a generally poor October giving way to stronger activity in November. That pattern will not prevent the quarter's growth in real gross domestic product from looking anemic, but it means that momentum is building, a plus for the economy early next year.

PROFITS RECOVER FROM THE RECESSION



Even as many businesses were hesitating on hiring and capital spending, and even as consumers said they were losing confidence.

Most significantly, the upward revision means that last quarter's advance in productivity was even stronger than the already handsome 4% annual rate originally reported by the Labor Dept. That helps explain why both corporate profits and real incomes of households have made solid demand-supporting gains over the last year. Those are the key fundamental forces that will continue to drive the economy forward.

THE TURNAROUND IN PROFITS is crucial, since earnings and cash flow are the fuel that will drive the rebound in capital spending, long the laggard in this recovery (chart). Commerce's accounting of corporate operating earnings shows that profits last quarter, while slipping 1.8% from the second-quarter level, posted a solid 12.2% increase from the year before.

Commerce's profits data may be of little use to in-

vestors, who need timely reports from individual companies and who see third-quarter earnings as old news. But investors, especially those skeptical of company reports, should take note that Commerce's accounting is consistent in its treatment of inventories and depreciation. It attempts to expense the cost of exercised stock options, and it is based on reports from thousands of companies large and small. It is thus representative of the entire economy and not skewed toward any industry, such as tech, media, or energy.

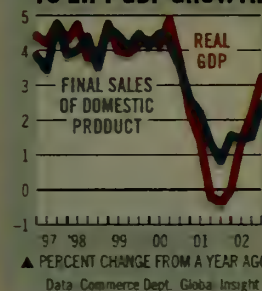
The 1.8% quarterly dip in profits reflects some loss of pricing power among corporations, but beyond that, the numbers need to be read carefully. The problem goes back to the fourth quarter of last year, when Commerce's measure of operating earnings soared 18.1% from the previous quarter. That jump reflected March legislation that gave corporations a generous, one-time, retroactive allowance for depreciation. Earnings this year have not been able to maintain that exaggerated level. They have, in fact, posted small quarter-to-quarter declines, ranging from 1.6% to 1.8% in each quarter. Making matters even more confusing, Commerce's measure of fourth-quarter earnings is bound to show a drop from the inflated level in the fourth quarter of 2001.

NEVERTHELESS, the 12.2% earnings increase from the year before, the second strongest yearly gain since 1997, indicates the profits upturn is real. In particular, the surge in productivity is cutting unit labor costs and lifting margins. Unit profits of nonfinancial companies are averaging 8.6¢ per dollar of real GDP so far this year, says Commerce, up from 7.9¢ in 2001.

The GDP revisions, moreover, show the profits improvement was not solely on the cost side. A steady increase in demand also is helping to lift earnings. Commerce's data show that overall sales to consumers, businesses, and government are up 2.5% from the previous year, the best annual pace in nearly two years (chart). While shoppers took a breather in September, they still seemed willing and able in October to continue playing a big role in propelling demand forward.

Plus, households' faith in the future took a turn for

DEMAND IS HELPING TO LIFT GDP GROWTH



Business Outlook

the better in November. The Conference Board's index of consumer confidence rose 4.5 points, to 84.1 (chart). Consumers are somewhat less jittery about future employment conditions, and the stock market rebound probably lifted the mood among households as well.

Consumers' brighter spirits are also reflected in their holiday shopping plans. In a separate report, the Conference Board said families expect to spend an average of \$483 on gifts this holiday season, up 5% from last year's budget. A good yearend shopping season would mean real consumer spending will head into the first quarter at a high level.

ANOTHER IMPORTANT GUIDE to how consumers view the future is their home-buying attitudes, and their willingness to commit to a mortgage remains high. Not only did Commerce report that third-quarter residential construction was stronger than first estimated, but housing demand remained solid in October. Resales hit an annual rate of 5.8 million, a six-month high, with the median home price increasing 9.8% from the previous year. New home sales decreased 4.5% in October, but that was down from a record high in September.

Low mortgage rates, which remain near 6% for a 30-year fixed loan, have helped to keep demand strong, and rising home prices are adding wealth to household balance sheets. The capital gains from homeown-

ership are helping to offset the downdraft from wealth losses in the stock market.

With the recent pace of new-home sales running faster than that of housing starts, new home construction may yet have some potential for further gains in coming months. In early November, builders said market conditions were still improving. The National Association of Homebuilders index, a measure of current and expected demand and buyer traffic through new homes, rose to 65, the highest level in two years.

Given housing's contribution to economic growth over the past two years, the sector is unlikely to add much in 2003. And construction's performance in the first quarter can be especially problematic, since a harsh winter could cut into building activity.

That leaves the other major sectors to carry the economy. Right now, the fundamentals for consumers and businesses, along with the expectations of some fiscal stimulus and a global turnaround, look favorable for demand in 2003. So while housing may not be a star performer next year, other sectors seem primed to move the economy past its current soft patch and onto firmer ground.

CONFIDENCE TICKS UP IN NOVEMBER



FRANCE

DON'T EXPECT A PICKUP FOR A WHILE

The French economy has slipped into the doldrums and may be stuck there for a while. Businesses aren't investing, and the government will have to tighten the purse strings in order to comply with the European Union's Stability & Growth Pact.

Consumers saved the day in the third quarter, preventing real gross domestic product from contracting. The economy grew a listless 0.2%, but the pace of household spending picked up, to 0.7%. Consumers are likely the primary engine of growth this quarter as well, amid signs of a stabilizing labor market and, for now, a retreat in oil prices. In October, consumer spending re-

bounded 1%, after a 0.9% fall in September.

But consumers need some help, and caution over a fragile global economic recovery and a possible conflict in Iraq have made companies hesitant to increase investment. Capital spending fell 0.8% in the third quarter, and factory output dropped 0.3% as companies opted to draw down their inventories to meet demand.

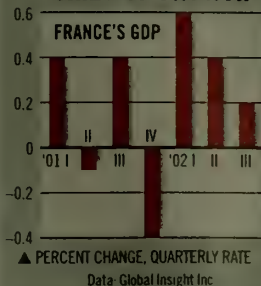
The situation does have some silver linings. Thinning inventories mean any ramp-up in capital spending should lead quickly to busier factories, and weak economies across the euro zone have raised the likelihood of an interest-rate

cut by the European Central Bank. Even so, French companies see only a modest improvement in investment and don't expect a real pickup until the second half of next year.

The drifting economy spells more trouble for the government's balance sheet. The 2002 budget deficit was bumped up to 2.8% of GDP on Nov. 20, from 2.6%. The government says the deficit should fall back to 2.6% next year, but that estimate hinges on 2.5% real GDP growth in 2003. Most economists expect real GDP to increase by no more than 2%. While tax hikes, à la Germany, currently appear unlikely, spending restrictions may be necessary to prevent the deficit from rising above the EU pact's 3% ceiling.

By James Mehring in New York

LITTLE WIND IN THE SAILS OF GROWTH





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RISING FROM THE TECH WRECK

Is the tech stock rebound for real—or a sucker's rally?

Give tech investors credit for one thing: They don't give up. Though tech sector executives continue to say they see little sign that demand will pick up before the second half of next year, tech investors have staged themselves quite a party since early October. The combination of improving macroeconomic numbers and surprisingly strong earnings reports from the likes of IBM Corp. and Hewlett-Packard Corp. was enough to push the NASDAQ index to a six-month high of 1,481.90 by Nov. 25. Although profit-taking brought the index down slightly the next day, it was still up 30% from its six-year low on Oct. 9. For the same period, the Standard & Poor's 500-stock index gained just 17.6%.

Moreover, the rally has lifted the tech sector across the board. Even a sad sack like Net software company Commerce One Inc., where quarterly revenues have dropped 86% over the past two years, saw its stock jump 80%, to \$5.40, in the past month. "Investors are still obsessed with tech," says Donald Luskin, chief investment officer for Trend Macrolytics, a Menlo Park (Calif.) research and in-

vestment firm. "They can't let go of it."

Does the runup signal an end to the tech sector's long slump—or is it a sucker's rally waiting to lure another round of victims? While it looks like investors may have gotten ahead of the fundamentals for the moment, there's more to this rally than a head fake. Investors have picked up that the slide in revenues and earnings has stabilized and the risk of downside surprises is waning.

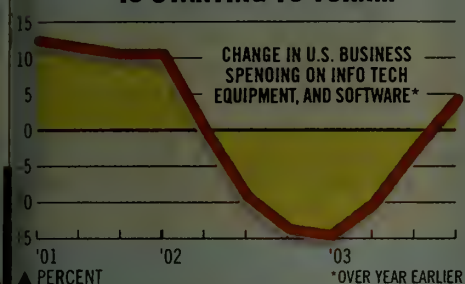
The biggest factor fueling the rise is the sense tech is finally bouncing up from the bottom; there are even signs that the telecom sector may be coming out of its slump (page 86). After five quarters of sickeningly sharp declines, business spending on tech appears to be turning. According to the Commerce Dept., businesses spent \$406.9 billion on tech in the third quarter, the third straight quarter that spending increased. More important, that was a 4.3% gain over last year's third quarter—the first time in almost two years that spending grew over the same quarter a year earlier.

Even more promising, spending forecasts show growth slowly returning next year. Despite the yearend strength, worldwide tech spending

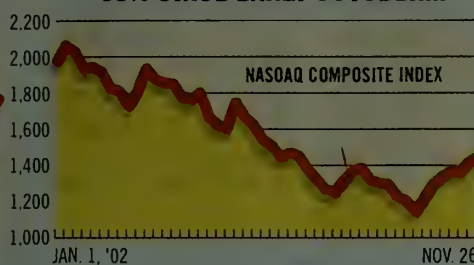


IRRATIONAL EXUBERANCE?

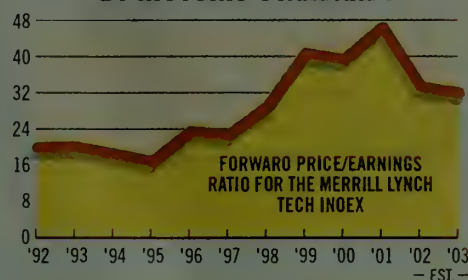
HIGH-TECH SPENDING IS STARTING TO TURN...



...SENDING STOCKS UP 30% SINCE EARLY OCTOBER...



...BUT VALUATION REMAINS HIGH BY HISTORIC STANDARDS



Data: Commerce Dept., Bloomberg Financial Markets, Merrill Lynch & Co.

Overall will still drop 2.3%, to \$874 billion, this year, according to market researcher IDC. But next year, IDC forecasts spending will increase 5.7%. Sure, that's still less than half the growth experienced in the late 1990s, but it does portend a moderately healthy year more in line with traditional growth rates of roughly 10% annually. "No one is saying we're going to see a blowout year for technology," says Kevin White, an IDC economist. "But we're starting to see, slowly, some signs of improved growth."

Such glimmers of hope sparked the tech rally. Initially, the surge was driven by positive news from bellwether companies like IBM, which was enough to send money managers diving back in, lest they miss a recovery. But other factors have driven the market forward too. Veteran traders also bought up shares in anticipation of a seasonal rally that is typically driven by corporate managers making end-of-year orders to spend their remaining

budgets. Turbocharging the rally were hedge funds and other short-sellers frantically covering their positions. As of Oct. 15, traders were shorting 4.1 billion shares of NASDAQ stocks—twice the level of 1999.

Is the rally sustainable? Until stronger demand does materialize, many analysts believe it's close to running its course. Despite two years of corrections, tech stocks are still overvalued compared with historical standards. The forward price-earnings ratio of Merrill Lynch & Co.'s Tech 100 is currently 33.09. While well off the high of 70 hit in March, 2000, that's nearly double the average of p-e's before the tech boom started in 1996. "I think the stocks have gotten out ahead of themselves," says Steven Milunovich, tech strategist at Merrill Lynch. "Ultimately, we could go back and test recent lows."

It doesn't help matters that tech execs continue to be circumspect about their prospects. Part of that, of course, is human nature: Having been brutally punished for being too optimistic at the start of the downturn, few chief financial officers or CEOs see any upside in predicting

a turnaround until they are 110% certain it has arrived.

Most execs also say they see little evidence in their order books that tech sales will be anything but lackluster for the next two or three quarters. With revenue growth still virtually nonexistent, companies are meeting or exceeding their earnings forecasts largely through cost-cutting instead. Even HP CEO Carleton S. Fiorina, while crowing about earnings that beat Wall Street expectations by 2¢ a share, was cautious about the months ahead. "At this point," she warned on Nov. 20, "we don't see any meaningful improvement in [tech] spending or capital spending."

Still, investors aren't all shooting at shadows. The success companies have had cutting costs to the bone means that many have strong leverage in their profits once demand does return: Even a modest rebound in orders will fall straight to the bottom line. "The minute the orders come in, these stocks will shoot straight up," says Jerome Dodson, manager of the \$280 million Parnassus Fund, who now has 45% of his holdings in tech stocks.

Until then, however, the bargain hunters who have been jumping into tech for the past six weeks can be expected to go only so far. Unlike the go-go fund managers who snapped up tech stocks at ever-higher prices in the '90s, these

Execs don't see a big lift in tech spending right away. And stocks are still overvalued

folks don't seem willing to keep buying. After picking up Applied Materials Inc. for \$11 a share, Marty Whitman, manager of the \$2.3 billion Third Avenue Value Fund, admits he wouldn't touch it at its current \$17. And after scooping up 12 million shares of Sun Microsystems Inc., Bill Nygren, a portfolio manager at the \$3.6 billion Oakmark Fund, is done with his tech shopping. "In general, I do not think tech stocks are as attractive as nontech stocks," he says.

Where is demand likely to pick up first? Investors are keeping a close eye on software and services, which IDC expects will grow by more than 10% next year. Cash-strapped corporate tech buyers are looking for low-cost alternatives to the pricey solutions they once snapped up, such as software that renders computer networks less complex. J. Clifford Dodd, chief information officer at health insurance giant Kaiser Permanente, says he is shifting money into technologies that will

digitize and organize patient records while simplifying Kaiser's network.

Chip demand, meanwhile, has started to wake up in some sectors. Intel Corp., the world's biggest supplier of flash memory chips, announced on Nov. 25 that prices would rise as much as 40% on Jan. 1. The reason: Cell-phone and handheld makers are adding memory-intensive applications, such as digital music players and cameras, to high-end devices. Intel's rival Advanced Micro Devices Inc., which

COMMENTARY

By Robert D. Hof

THE KICK IN THE PANTS THAT TECH NEEDS

Tom DeMarco preaches an unpopular gospel. A fellow at the info-tech consultants Cutter Consortium, he travels the country exhorting corporations to boost purchases of technology as a way to vault ahead of pinchpenny rivals. These days, he admits, "it's a tough sell." But DeMarco is fighting much more than a stagnant economy. The tech sector suffers from deep problems that will take real work and creative thinking to fix. Simply waiting for a recovery won't be enough.

Many startups can't get funding. Corporate and university research isn't getting to market fast enough. And innovative technologies that could recharge tech spending, such as online music sharing and wireless services, are getting stifled by media giants and outdated government policies. Says Richard G. Sherlund, an analyst at Goldman, Sachs & Co.: "There isn't any major new product cycle or major innovation that companies are saying we have to spend on."

What's needed is new thinking. That's true not just at tech companies but also at universities, in government, and at media and telecom com-

panies. A series of steps, from slashing the size of venture funds and trying new ways to commercialize research to lessening reliance on litigation to solve disputes, could help clear the way for innovations to get to market.

These aren't quick fixes. That's not what tech needs anyway. Now that tech's deep freeze may be starting to thaw, it's all the more important to tackle the bigger problems—those that could prevent it from resuming its former 10% annual growth rate. Solving them would help tech suppliers—and the entire economy in the long run.

Here is what's wrong with tech today, and

what's needed to get it back on track.

VENTURE CAPITALISTS ARE SHYING AWAY FROM EARLY-STAGE STARTUPS

► Startups have a math problem. bulking up in the boom, leading venture funds top \$500 million. To invest that money, they now generally pour \$10 million or more apiece into late-stage companies. That leaves startups, which typically need less than that, the lurch. Meanwhile, individual "angels" and corporate investors, who stepped in at the early stage, are hiding after losing big in the tech boom.

As a result, a lot of promising startups are withering. VCs invested in only 10% of startups in the third quarter, vs. 20% in early 1997—before the big boom. "I wonder how many good ideas are out there getting traction because they aren't getting funded," says David V. Foran, chief technology officer at Kaiser Permanente.

Vcs need to downsize their bets. A few have, but not enough. Ending the need to invest huge sums would encourage them to fund more on early-stage startups. Most of a startup's need to suck it up and take risks comes in the first 18 months. Today, most won't consider startups without seasoned teams and obvious markets. Those are much tougher to find than they applied even before the boom. Notes Guy T. Kawasaki, managing



ely needs a revenue boost, says it has
gun to benefit from the trend, too.

Most hardware manufacturers, how-
er, have yet to see much change. CIOs
ese days aren't interested in buying
uch beyond cheap servers—and then
ly if the old one sorely needs replacing.
predicts hardware sales will increase
just 1.9% in 2003. But that's a lot
tter than the nearly double-digit de-
nes of the past two years.

It should come as no surprise that the
panies positioned to take advantage
the economy's returning strength are
a familiar trio of Microsoft, IBM, and

Dell. All three have emerged from the
downturn stronger than ever. Nov, Mi-
crosoft and IBM are each pitching inte-
gration software to solve companies' com-
plexity problems.

Meanwhile, Dell continues to be the
picture of a company doing it right. In
the hotly contested server market, for
example, Dell is selling \$4,000 devices
that compete head-on with competitors'
machines selling in the six figures. Such
low-priced gear has allowed the company
to continue to steal market share from
rivals throughout the downturn.

Indeed, despite tepid demand for com-

puter hardware, Dell is one of a few
companies to consistently show revenue
gains. With unit shipment up 28% in the
third quarter over the same period in
2001, the company booked 22.5% higher
sales—easily the best performance among
tech's heavyweights. It's a smart way to
do business in a soft market. And, as
the sector begins to improve, smart tech
investors will put their money on com-
panies—like Dell—that are well-posi-
tioned for the coming rebound.

*By Jim Kerstetter in San Mateo,
Calif., and Dean Foust in Atlanta, with
Cliff Edwards in San Mateo*

ector of Garage Technology Ven-
Palo Alto (Calif.) investment
If you applied those tests to
the large tech companies today,
ould not have been funded."

BETWEEN RESEARCH ADVANCES AND SIAL PRODUCTS IS GROWING

pressures have forced Lucent
ologies, IBM, Xerox, and others to
asic research, the fount of inno-
like the chip, the disk drive,
Internet. Universities are doing
research, but it's narrowly fo-
So fewer breakthroughs get to
Says Henry W. Chesbrough, a
d Business School assistant pro-
"Stuff sits on the shelf because
gap."

developments
elp close it.
reaching out to
forge partner-
with startups.
Corp., too, has
s Palo Alto
ch Center to

research to other companies.
me academic researchers are
out of their cubbyholes. Stan-
niversity now has a bioengineer-
gram that brings together engi-
t, medical, and other faculty to
rate on projects such as artificial
s. More researchers, corporate
ademic, should open their arms.

PLANTS ARE THWARTING INNOVATION BY THREATENING TECHNOLOGIES

nderstandable that the record
ies went ballistic over the online
sharing service Napster. It
people steal music. But with
60 million users at its peak, the

appeal went beyond the joy of theft.
"Clearly, technology offered a new rev-
enue stream to content owners and a
better experience for consumers," says
tech analyst and former VC Lise Buyer.
But the implicit threats of lawsuits
prompted her and other VCs to walk
away from several music startups last
year. The battle has moved to video,
too, as broadcasters have sued makers
of digital video recorders such as
SONICblue Inc.

Media companies should rein in their
lawyers. Their own limited music-sharing
sites would become much more appeal-
ing—and spur more purchases of music,
not to mention PCs, MP3 players, and
broadband access—if they instead tapped
new ideas for making downloads pay off.

FRESH IDEAS Sure, Napster helped people steal online music, but it nevertheless attracted 60 million users at its peak

They could sell \$50 digital download
certificates for a certain number of songs, or
charge users just for one song at a time.
They could use cable TV's pay-per-view
model. And instead of copy-proofing CDs
so they don't play on PCs, they could in-
stead include promotions on the CDs to
help spur other sources of revenue, such
as selling concert tickets online. For-
rester Research Inc. reckons music
downloads could net \$2.1 billion, or 17%
of record industry sales, by 2007.

GOVERNMENT SPECTRUM POLICIES ARE LIMITING NEW SERVICES SUCH AS THE WIRELESS INTERNET

► Wireless networks, which let
people surf the Internet at
high speeds in

airports and corporate offices, are
growing by leaps and bounds. Even so,
they will probably run short of spec-
trum soon, while television broadcasters
hog large swaths of it for their dwin-
dling audiences. "That could limit inno-
vation," says Rick Rotondo, vice-presi-
dent for technical marketing at wireless
technology supplier Mesh Networks
Inc. New technologies could allow vari-
ous services to share the same spec-
trum without interfering with each oth-
er. But cellular carriers are fighting the
calls to open up spectrum that they
paid billions of dollars to obtain.

Resolving the fight won't be easy,
but it is doable. The Federal Commu-
nications Commission, for instance, could
reserve more airwaves for these emerg-
ing technologies and
force carriers and
broadcasters to share,
where technology al-
lows it. One positive
sign: A Nov. 15 FCC
report called for
sweeping changes in
spectrum policy, including use of these
new technologies.

These are all tough steps. And they
won't immediately pry open the tight
corporate budgets that are keeping
many tech suppliers in the dumps. Nev-
ertheless, addressing these issues now
will give tech a fighting chance of re-
turning to its glory days.

*Silicon Valley Bureau Chief Hof writes
about technology from San Mateo, Calif.*



COMMENTARY

By Mike McNamee

WHY RESEARCH REFORM WON'T HELP THE LITTLE GUY

Wall Street's analyst woes are finally nearing an end. On Nov. 23, New York State Attorney General Eliot Spitzer, together with regulators from other states and the Securities & Exchange Commission, began briefing a dozen big investment banks on how much they'll have to pay to settle charges that their analysts biased stock ratings to win lucrative initial public offerings and other banking business. Regulators are hitting Citigroup for \$500 million and Credit Suisse First Boston for around \$200 million.

But what benefit will Mr. and Mrs. 401(k)—the victims of the boom-and-bust excesses that analysts helped create—reap from the settlement? Unfortunately, not much. In addition to money, the deal will create greater separation between the banks' research analysts and their investment banking co-workers, and it will force the banks to invest in independent research. But those moves will do little to help the average individual investor make more informed decisions about buying and selling stocks than he or she did before.

Regulators wouldn't agree with that assessment. They're imposing stricter rules on analysts' pay and contacts with investment bankers in hopes of reducing the temptation to bestow glowing ratings on companies being courted for banking business. Those rules will help clean up the market, but so long as banking pays the bills, they can't eliminate research biases.

The SEC and the states also figure that individuals will benefit from independent research by Wall Street boutiques. For the next five years,

each of the Street's big banks will be required to employ an SEC-approved monitor who'll buy independent analysis whenever the bank issues a report on a company whose stock it underwrote. If the two recommendations differ widely, SEC officials say, the banks' brokers must inform clients of the disparity.

But even some regulators view

Disparities in
by regulators
and the SEC
investors will
better advice
than they do

NEW YORK AG
ELIOT SPITZER



this idea with skepticism. "I'm not sure who ever looked at any of these reports anyway," says one SEC doubter. Forcing the banks to buy independent research "may be creating a product for which there's no demand," admits another regulator.

There might not be much supply, either. "The high-value research boutiques won't bid on this business," predicts Charles L. Hill, director of research for Thomson Financial/First Call. Independent researchers thrive by selling insights to sophisticated institutions such as mutual funds and pensions. Before a research shop makes its wisdom available to Merrill Lynch & Co.'s thundering herd, the firm has to worry about damaging its standing with the investing elite. Those analysts who appear on CNBC have no obligation to back up their recommendations by providing re-

ports to viewers. Individuals should not kid themselves: They'll never get the same insights as the big guys.

Even clients can have a hard time getting research unless their balances meet the brokerage's minimums—and that situation will persist. "Anyone who hears a recommendation should be able to get the underlying report at a reasonable price," says Patricia D. Walters, senior vice-president of the Association for Investment Management & Research, a professional society for analysts and money managers. "But that's not on the table."

Would complete access to research make for a smarter investing public? Probably not. Studies show that few individuals ever read past the buy or

sell rating to get to a report's details. That's not the only reason why complete access to research wouldn't help most individuals to become better investors. Studies by Brad M. Barber, a finance professor at the University of California-Davis, shows that Wall Street research tends to focus on small-cap growth stocks. That's the most fertile sector for IPO business, but it's hardly the basis of a well-rounded portfolio.

Small-cap growth has been a quagmire since the market peak in March, 2000: Analysts' lowest-rated stocks outperformed their top picks by 20 percentage points in 2000 and 2001, according to Barber's studies.

None of these objections is likely to stand in the way of the analyst settlement. Both Spitzer and his Wall Street foes are eager to wrap up before Christmas. The SEC, too, wants to finish the case so that the commission can take a longer look at how analysts operate in the fevered world of IPOs and stock-pushing. Commissioner Harvey J. Goldschmid, who'll head that effort, would be well advised to study how individual investors make their buy and sell decisions. The market's most vulnerable players deserve better.

McNamee covers the SEC.

WHAT'S IN IT FOR YOU?

There's not much for individual investors in the proposals to reform Wall Street research:

REBUILDING WALLS

Despite new rules on analysts' pay and their contacts with investment bankers, analysts are still likely to favor banking clients, biasing ratings

INDEPENDENT RESEARCH

Even with banks paying for independent reports, top analysts won't give up their lucrative institutional business to write for individuals

HUGE PENALTIES

Regulators intend to use more than \$1 billion in fines to buy independent research, not to better educate investors or offset past losses

LIGOPOLIES

OPENING UP THE CREDIT-RATING CLUB?

Federal regulators are likely to pave the way for new entrants

For years, the credit-rating agencies have operated almost like members of an exclusive club. Only three companies are authorized by federal securities regulators to appraise the creditworthiness of corporate and governmental bond issuers, creating a troika that wields enormous influence over the investment decisions of institutions and individuals. But that cozy arrangement may be about to change.

Why? The agencies' performance through the past year's wave of corporate scandals has been sharply criticized. First, Congress, bondholders, and others blamed the raters kept Enron Corp. at investment grade until just four days before it filed for bankruptcy in December, 2001. Then, as other companies went into trouble, the agencies took heat for slashing ratings too quickly.

Such criticisms led Congress—through the Sarbanes-Oxley corporate reform law—to direct the Securities & Exchange Commission to study the effectiveness of the ratings agencies. Their report is due back by the end of January. In the wake of hearings held on Nov. 15 and 21, the SEC looks likely to pave the way for new entrants. Says a SEC insider: "It's not in our interest to have a regime in place that unnaturally limits competition."

The existing agencies—Moody's Investors Service, Standard & Poor's (which, *BusinessWeek*, is a unit of The McGraw-Hill Companies), and Fitch—owe their elite status to an accident of regulation. In 1975, the SEC ruled that brokerage firms had to discount below-investment-grade bonds when calculating their assets, and that the bond ratings must come from a nationally recognized statistical ratings organization" (NRSRO). Without defining

the term, the SEC anointed Moody's, S&P, and Fitch as the sole NRSROs.

The franchise has made all three highly profitable—a fact that became crystal clear last year when Moody's released its earnings for the first time ever, following its spin-off from Dun & Bradstreet in 2000. Until then, numbers for the sector had been hard to come by. But given the 50% operating margins Moody's boasted in 2001, it's little wonder that

Best—find ammo for their cause in a September survey by the Association for Financial Professionals. The poll found that 29% of financial execs who work for companies with rated debt believe their ratings are inaccurate, while 40% think it takes too long for changes in the company's finances to show up in the rating.

The three leaders have been circumspect about increased competition. S&P President Leo O'Neill says he would welcome newcomers, provided they offer high-quality, independent research. While Moody's President Raymond W. McDaniel says his company is "neither in favor nor opposed" to more competition, he worries that "new entrants may compete in the market by offering higher ratings" than the leading players.

The three gripe that they've come under withering and often unfair criticism since Enron broke. Execs insist they were doing their best amid the chaos of the corporate meltdowns. "We are looking at the fundamental credit quality of companies we rate, and sometimes that changes more rapidly in periods of market volatility," says McDaniel.

Despite the carping, the SEC is unlikely to throw the gates open to all comers. The commission's big fear: Issuers would be tempted to shop for the highest ratings. A more likely scenario: The SEC will clarify the now-opaque process of gaining NRSRO status, and a few rivals will be admitted to the club.

Will a jolt of competition make for more accurate and timely ratings? That depends on whether the newcomers can gain more than a toehold in a market so dominated by two behemoths that even No. 3 Fitch, has had a tough time competing. "You can't just put ratings out there and expect people to follow them. You have to have a reputation for reliability," says Stephen W. Joynt,

Fitch's president and CEO. It took Fitch more than four years and investments of \$40 million to become profitable. The smaller fry may get in on the action, but they'll still have their work cut out for them.

By Amy Borrus, with Mike McNamee, in Washington



AN INNER CIRCLE: ROOM FOR MORE?

Three companies dominate the credit-rating business.
Should the SEC open up the lucrative market?

YES

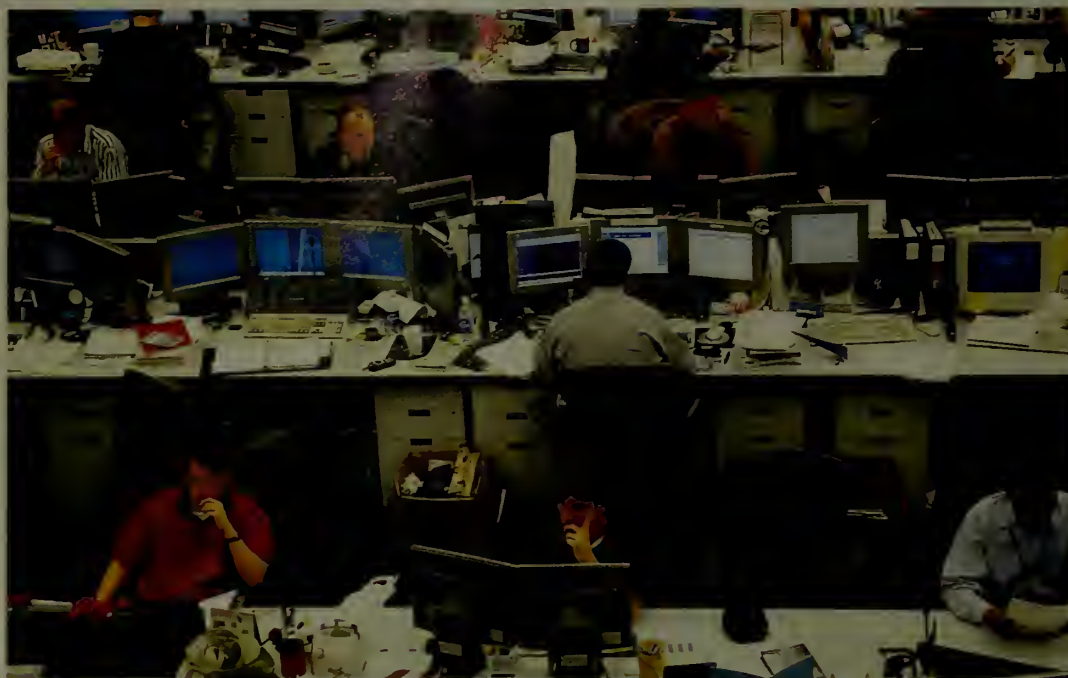
- ▶ The agencies' protected market is an anomaly in U.S. business
- ▶ Competition would foster more accurate and timely ratings
- ▶ There are too many debt issues for just three agencies

NO

- ▶ Newcomers may inflate ratings to win business
- ▶ More ratings may send mixed signals to investors
- ▶ Monitoring multiple agencies will tax regulators

smaller credit-raters covet NRSRO status. Says Glenn L. Reynolds, CEO of CreditSights Inc., an independent credit research firm: "It's like getting a free pass to an ATM machine."

Would-be competitors who think they can do a better job—including Egan-Jones Ratings, Lace Financial, and A.M.



ENERGY TRADING

ALTERNATE POWER SOURCE

Investment banks and oil giants replace fallen players

You'd be hard-pressed to find a villain as universally loathed as the energy trader. The sector's sham deals and price-gouging have hurt investors, damaged the power industry, and forced some giants of trading to the brink of bankruptcy. The latest: On Nov. 20, a major investor accused El Paso Corp. of inflating profits through bogus trades as recently as August. And on the same day, Swiss bank UBS Warburg said the lack-luster market would force it to scale back the energy trading operation it acquired from Enron Corp. in February. Blasts one California consumer advocate: "All traders offered us was manipulation. My position is goodbye and good riddance."

Not so fast. It may be a reviled symbol of boomtime excess, but energy trading is here to stay. As firms such as Dynegy and El Paso turn out the lights on their trading floors, the banks, big oil producers, and insurers are tiptoeing in. Lured by the potential profits to be made in hedging volatile energy prices, new leaders are filling the vacuum left by the failures of the energy sector. In a few years, say analysts, they'll dominate an industry Enron made famous. Says J.

Michael Stice, president of ConocoPhillips Gas & Power, which is beefing up its trading team: "That void has offered us an opportunity."

Mind you, it won't be the frenzied bazaar it once was. There's no going back to days when traders shamelessly pumped up trading volume and a top Enron trader generated \$750 million in profits in a single year. Today, Enron is bankrupt and its former rivals are being punished by once-generous creditors for their crushing debt and poor cash flow. The latest blow: On Nov. 26, Moody's Investors Service downgraded El Paso's debt rating to junk.

El Paso is leaving the trading business—and it's not alone. Eight of the top 10 electricity traders have either stopped trading or are scaling way back, including former stars like American Electric Power, Aquila, and Mirant. "That part of our business will shrink as our asset base shrinks," says Mirant Chief Executive S. Marce Fuller. Meantime, the number of megawatts traded daily at the Midwestern Cinergy hub, the country's most active power marketplace, has plummeted 70%, to 4,884, from last year, says energy market tracker Platts.

So why doesn't any of this worry the survivors and new arrivals? "We will benefit from having persevered," says Neal Shear, global head of commodities at Morgan Stanley, which has been trading energy since the mid

FADING MEMORY

Mirant's trading desk in Atlanta in January. It has since scaled way back

1990s. Other emerging leaders include Goldman Sachs, Bank of America, oil giant ChevronTexaco, an insurer American International Group. As the industry's credit problems are resolved, the players expect trading volume to tick up. Most trades will likely be short-term deals linked to hard assets such as plants and pipelines, not long-term bets that depend on near-fictional forecasts of future power prices. Much demand is coming from companies needing a mechanism to manage the risk of fluctuating energy prices.

For banks and insurers, their ace in the hole is their solid balance sheet. When trading surged in the late '90s, traders were forced to borrow heavily to back deals. So when business crumbled, they were caught short of cash. With plenty of capital and solid credit ratings, banks have no such worries. Their experience trading in commodities, tight regulatory rules, and internal controls should prevent Enron-style risk analysts say. And unlike energy firms that touted trading as a growth engine, these diversified giants can wait for the market rebound.

Of course, that won't happen until the system regains credibility. UBS's experience with Enron's trading business is instructive, analysts say: The bank bet too big on a revival of trading and had to scale back.

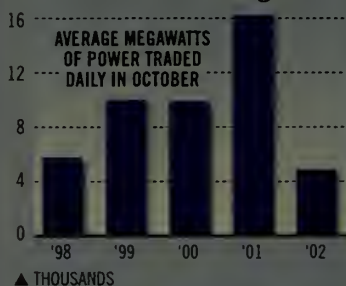
Indeed, there's no getting around the fact that energy trading remains a risky business. Regulators are tightening rules to force

greater disclosure. Meanwhile, deregulation has slowed to a crawl, threatening the outlook for companies hoping to profit from greater competition. Says analyst John E. Olson, chief investment officer of Sanders Morris Harris Inc.: "We're going to see power trading shrink to a shadow of itself." Given how scary the original version was, that might not be a bad thing.

By Andrew Park with Wendy Zellner in Dallas, and bureau reports

FLICKERING TRADES

Energy trading has collapsed at the key Cinergy Midwestern trading hub



▲ THOUSANDS

Data: Platts



the 260-hp Acura TL Type-S. Most cars simply get you from here to there. For those who enjoy the pavement
-between, there's the TL Type-S. It sports a robust 260-hp V-6, laser-quick acceleration, available OnStar® service
and near-telepathic handling. Thank you, Mr. Cartographer. Call 1-800-TO-Acura or visit acura.com. **ACURA**

PHARMACEUTICALS

VACCINES ARE GETTING A BOOSTER SHOT

As their profit potential jumps, so does new investment in R&D

In the pharmaceutical industry, vaccines have long been poor stepsisters to big, glamorous drugs. Immunization campaigns have worked wonders, wiping out scourges such as polio. Yet annual global sales of vaccines are just \$6 billion—about \$1 billion less than what best-selling cholesterol drug Lipitor generates in one year. And the number of major companies selling vaccines has shrunk from 20 in the 1980s to just 4. For many years, “it wasn’t an economic business to be in,” says Dr. Paul Drayson, CEO of PowderJect Pharmaceuticals PLC, a vaccine maker in Oxford, England.

No more. In late November, Merck & Co. reported that its experimental vaccine could ward off infection from cervical cancer-causing human papillomaviruses (HPV). And GlaxoSmithKline PLC is working on one for herpes. If proven safe and effective in larger trials, both could become blockbusters, analysts say. And that’s just the start. Company research-and-development pipelines are bulging with nearly 100 vaccines against infectious agents, with dozens more being engineered in academic and government labs against everything from Ebola virus to West Nile disease.



The surprising result: Annual growth for the vaccine industry will rise to the mid-teens per year, up from an historic average of 10%, according to a recent report commissioned by the Global Alliance for Vaccines & Immunization (GAVI). “It’s really a good time to be in the vaccine business,” says Dr. Thomas

P. Monath, research chief at Acam Inc. in Cambridge, Mass., which is churning out smallpox vaccine for the U.S. government.

Moreover, vaccines are becoming more versatile. Traditional immunizations prime the immune system to fight off parasites, bacteria, or viruses such as flu. But increasingly, vaccines are tackling diseases beyond the infection itself. Merck’s HPV vaccine doesn’t just prevent infection from HPV—it also holds the hope of eliminating the cervical cancer caused by the virus. Other experimental vaccines are aimed at protecting the immune system to clear away malignant tumors or chew up the brain tangles associated with Alzheimer’s disease. “We are ready for a renaissance in the whole vaccine area,” says Stephen A. John

NEW AIM Scientists want to prod the immune system to chew up tumors and Alzheimer’s damage.

ston, a biochemist at the University of Texas Southwestern Medical Center.

What explains the resurgence of vaccines? Credit a combination of smart policy moves, advances in science, and a big change in the economics of the business. Back in the 1980s, companies bailed out of vaccines because prices—and profits—were low, and because they faced huge legal threats from people harmed by vaccines. Congress largely solved the liability issue with a 1986 bill setting up a program to compensate victims. “That led to increased research, and we are seeing the fruits of that now,” says independent drug analyst Hemant K. Shah.

The ability to command premium

Feeling Better

Improved economics have led to more R&D and new vaccines, but the road to new products is far from smooth

GOOD NEWS

- Higher prices have led drugmakers to introduce newer products. Wyeth’s Prevnar costs \$232 for a four-dose course.
- Few rivals and no generic competition mean profits extend for many decades.
- A 1992 bill eased liability, fueling an increase in R&D that’s now bearing fruit.
- Marketing costs, relative to sales, are low, and potential markets are huge.

BAD NEWS

- R&D costs remain high because the FDA requires large trials to ensure that no serious side effects will appear.
- Manufacturing is complex: For some vaccines, it takes months to make one batch.
- Many older vaccines earn low margins and are costly to produce.
- Little profit exists in selling vaccines for Third World scourges such as malaria.

002 AT&T

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** Forrester Business Technographics Benchmark, July 2002.

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MOVING BUSINESS FORWARD

prices helped, too. In the late 1980s, Merck and SmithKline launched gene-spliced vaccines for hepatitis B. At \$30 to \$40 per dose, they cost well above what is charged for common childhood vaccines used to prevent measles, tetanus, or whooping cough. That marked the start of "increased interest in vaccines as a business as opposed to a public-health intervention," says Piers Whitehead, vice-president of biotech company VaxGen Inc. in Brisbane, Calif., and co-author of the recent GAVI report.

Now, vaccines are racking up profits once seen only with blockbuster drugs. The best example is Wyeth Corp.'s Prevnar, a vaccine that helps protect children from the pneumococcal bacteria that cause meningitis. Prevnar's price is a lofty \$232 for a four-dose course. Lehman Brothers Inc. analyst C. Anthony Butler predicts that the vaccine, with estimated sales of \$625 million this year, could soon be a \$1.5 billion prod-

uct. "Wyeth's success has shown other companies that there is a potential for vaccine blockbusters," says Dr. Stanley A. Plotkin, consultant to Aventis Pasteur Ltd., one of the four big vaccine makers, and professor emeritus at the University of Pennsylvania.

Improved economics have prompted vaccine makers to boost R&D spending. The four industry leaders—Merck, GlaxoSmithKline, Aventis Pasteur, and Wyeth—are estimated to spend more than \$750 million a year on vaccine R&D—as much as a fivefold jump at some companies since '92. Scientific advances also are helping prompt renewed interest. One hot idea is to develop a basic vaccine that could be customized for a range of diseases. Acambis, for example, is using its yellow-fever vaccine as a way to deliver bits of other viruses—such as West Nile—to the immune system. Other drugmakers are creating vaccines made of DNA that

could be spliced quickly with new genes when novel diseases or bioterror agents suddenly emerge (box).

None of this will make vaccines glamorous—or as profitable—as drug. For one thing, getting a vaccine approved can take longer than it does for drugs. The Food & Drug Administration wants proof that no serious side effects will appear even when the product is given to tens of millions of people. But that's tough, as evidenced by the current controversy over whether mercury in past children's vaccines could have caused autism.

Finally, scientists caution that they're still a long way from creating vaccines for viruses crafty enough to hide from the immune system, such as HIV. But with a host of important new vaccines now in companies' pipelines, this former pot stepsister is getting ready for the ball.

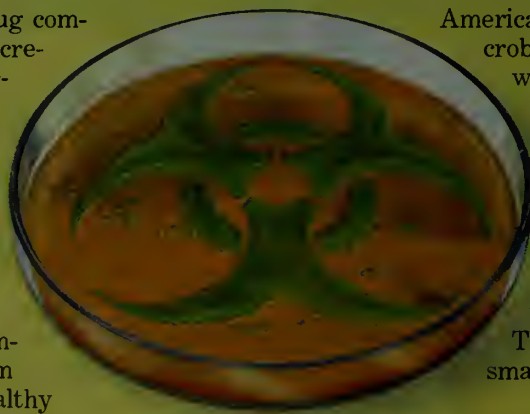
*By John Carey in Washington
with Kerry Capell in London*

YOUR TAX DOLLARS AT WAR

When drug companies create vaccines against known public health problems such as herpes or human papilloma virus, they can increasingly command premium prices and healthy profits.

But getting companies to invest in vaccines for less immediate threats, such as smallpox or other bioterror agents, isn't so easy: There is usually no market unless the threat materializes. Even tougher is trying to anticipate and defend against infectious agents that now exist only in a terrorist's grim imaginings.

That's why Uncle Sam is whipping out his checkbook. Already, Washington is planning to spend more than \$1 billion on vaccines for smallpox and anthrax. And taxpayers are helping to fund vaccines for West Nile virus and other less familiar pathogens. "The government has to buy and stockpile vaccines and drugs against nonexistent diseases," says Ronald M. Atlas, co-chair of the



American Society for Microbiology's biological weapons task force.

Yet even a vaccine stockpile would be of limited use against the worst nightmare: a virulent new agent cooked up by a terrorist. The world got a small but nasty taste

Uncle Sam is shelling out plenty for drugmakers to fight unknown biothreats

of how easy this can be when, in 2001, Australian scientists inadvertently created a superbug. After adding a gene to generally benign mousepox virus to try to create a mouse contraceptive, the engineered virus killed every mouse it struck.

In some cases, vaccines might slow an epidemic of such a superbug. After all, says Dr. Gary Nabel, director of the Vaccine Research Center at the National Institutes of Health, it's easier for terrorists to create anthrax that shrugs off antibiotics like

Cipro than to engineer a strain that overcomes an immune system primed with a vaccine.

Still, should terrorists create something too nasty for existing vaccines to fight, researchers have other weapons. In a project funded by the Defense Advanced Research Projects Agency (DARPA), Stephen A. Johnston, a biochemist at the University of Texas Southwestern Medical Center, has created a fast way to crank out vaccines against new biothreats.

The idea is to quickly test cocktails of genes from a bacterium or virus to see which of the proteins made by the genes can stimulate immune responses in animals. DARPA managers figure the method may make it possible to find vaccine candidates in a few days. The problem, however, is that proving the vaccines are safe and effective—and making enough to protect a city or country—would take months, at best.

To really protect the country, it's not enough for the government to store vaccines against known threats, scientists say. We also must anticipate what microbes our enemies may try to create. Scientists are now mobilizing to meet that challenge.

By John Carey in Washington

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PUBLISHING

THE ZAGAT GUIDE TO JUST ABOUT EVERYTHING

Movies, nightspots, and golf courses are now within its scope

Tim and Nina Zagat have warm memories of 1982. That's the year they began dropping off their quirky, quote-filled guides at New York bookstores from the back of their brown Toyota Corolla station wagon. Says Tim, a former lawyer who is now 62: "It started out as a hobby."

No more. The founders of Zagat Survey LLC are pushing out the edges of their empire, built on consumer surveys. Zagat's restaurant guides, which retail for \$10.95 to \$14.95, now cover 70 cities worldwide. Lately, the publisher has branched out into guides for movies, hotels, airlines, car rentals, and nightlife. In November, it even launched a guide for U.S. golf courses. Music and New York shopping could be next. "We are tapping into people's passions," says Nina, 60, also an ex-lawyer. "They'll always have something to say."

The Zagats are also trying to tap deeper into customers' wallets. In October, the company began charging consumers \$14.95 a month for access to the once-free zagat.com. And it is making a big push to sign up corporate clients, such as Toyota and Merck, that are willing to pay big bucks for customized guides and advertisement tie-ins. Both new tactics, though, are risky. Few online-content companies have ever made money charging those who visit their sites. And the corporate tie-in strategy could weaken the Zagat guides' reputation for independence.

Still, taking smart risks has transformed the Zagats into a five-star couple. They live on Manhattan's ritzy Central Park West, not far from one of their favorite restaurants, Jean Georges. Privately held Zagat, with 110 employees, is adamant about not disclosing its rev-

enues or earnings, but sources in the industry say revenues easily exceed \$20 million. Tim says he expects revenues to grow by 25% in 2003. Its New York restaurant guide alone sells 650,000 copies a year.

Of course, the Zagat empire would not be possible without the more than 200,000 people selected by Zagat to be in the network of reviewers. They can be wine society members, the ad exec who dines out a lot, or just average folks. All agree to submit their reviews online, without pay. Thousands of surveys are sent in each day. The seven-person research team is kept busy all year tabulating the results into numerical ratings, city by city. From

there, the data are sent to the 20-person editorial staff, to be distilled into pithy reviews. "It's all about the idea of listening to other people, a consumer democracy," says Tim.

Publishing those viewpoints has helped Zagat become a powerful brand, so much so that corporations increasingly want tie-ins. Zagat currently has agreements with 3,000 corporations. Some just want to put their logo on the

cover of a guide they use as a giveaway. Others, like Toyota Motor Corp., want something more customized. The car maker has worked with Zagat to create a guide to the Top 50 "Feel Good" movies, inserted in print ads that exploit "the feeling" of driving a Toyota. Zagat also has wireless licensing deals with AT&T, Verizon, Nextel, and others.

Will those growing corporate con-

tractions risk diluting Zagat's reputation by being the voice of rich people? Tim and Nina don't think so. In fact, they've used a \$32 million investment from outside investors to help develop the \$14.95 month online subscription.

BRANCHED OUT: Zagat boasts a spiffed-up

Web site and 3,000 corporate tie-in agreements

service. Will dine and moviegoers really fork over that kind of dough? The Zagats claim they have so 100,000 subscribers. But only a handful of publications, such as *Consumer Reports*, and *The Wall Street Journal* have been able to make

a go of charging for online content. And not everyone shares the Zagats' optimism. "If you're going to pay up for the Internet, why in the world would you pay for a book that will sit on your shelf?" asks one publishing exec.

Still, Tim and Nina Zagat have momentum in their favor. And they're not ruling out taking the business public in the future. But for now, these tiny publishers-turned-multimedia-hotshots have plenty to keep them busy.

By Tom Lowry in New York

ZAGAT SURVEY

MOVIE GUIDE

Top "Feel Good" Movies

Based on the opinions of thousands of avid moviegoers, the Zagat Survey Movie Guide presents the Top "Feel Good" Movies of all time, listed below in order of Overall Quality.

1. The Wizard of Oz
2. Singin' in the Rain
3. Sound of Music
4. My Fair Lady
5. It's a Wonderful Life
6. The Shag
7. Mary Poppins
8. E.T. The Extra-Terrestrial
9. Shrek
10. When Harry Met Sally
11. Yankee Doodle Dandy
12. Zerkow the Great
13. Miracle on 34th Street
14. Babe
15. Ice Cube
16. Romy
17. Shakespeare in Love
18. Sound by Mike
19. Moonstruck
20. Gap
21. American Graffiti
22. Forrest Gump
23. A Hard Day's Night
24. The Untouchables
25. Breathing Aways
26. Big
27. On the Town
28. Frosty the Snowman
29. In the Company of Men
30. Grease
31. Pretty Woman
32. The Nanny
33. Lemony Snicket's A Series of Unfortunate Events
34. Father of the Bride
35. Parenthood
36. The Untouchables
37. A League of Their Own
38. Spinal Tap
39. Baby Boom
40. The Untouchables

ZAGAT SURVEY

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EDITED BY MONICA ROMAN

LVMH'S DESIGNER SUIT

THE CONFLICT-OF-INTEREST cloud over Wall Street investment banks has now moved across the Atlantic. French luxury giant LVMH Moët Hennessy Louis Vuitton is suing Morgan Stanley in a Paris court, seeking \$100 million in damages. LVMH alleges that Claire Kent, the bank's London-based luxury-goods analyst, unfairly hyped the stocks of Morgan Stanley clients such as Gucci and Burberry, while taking an overly downbeat view of LVMH. Morgan Stanley vehemently denies the charge.

It'll be a tough case to prove because Kent's ratings for luxury companies aren't out of line with other analysts. So why go to court? Industry-watchers suspect the case stems from LVMH Chairman Bernard Arnault's feud with fellow French tycoon François Pinault, who snatched Gucci away from

LVMH in a bitter legal fight that ended last year.

RUNNING AFOUL OF 'FAIR DISCLOSURE'

WHAT'S "FAIR DISCLOSURE?" The Securities & Exchange Commission planted some signposts on Nov. 25, with its first enforcement actions under Reg FD, adopted in August, 2000, to block selective leaks to institutions and analysts. The SEC fined Siebel Systems \$250,000 and slapped cease-and-desist orders on Raytheon and Secure Computing. The SEC alleged that the companies revealed crucial data—which moved stock prices as much as 20%—in one-on-one conversations or calls closed to ordinary investors. The companies didn't admit the violations.

ZERO TOLERANCE FOR ZERO TARIFFS

IS THE WORLD READY FOR zero tariffs? The Bush Administration thinks so. It's proposing plans to phase out taxes on imported manufactured goods worldwide by 2015. But much of the 144-member World Trade Organization is unlikely to embrace the idea. The U.S. already has some of the world's lowest tariffs on manufactured goods. But much of the developing world keeps tariffs up to protect its own industries. Poorer nations, which make up the majority of the WTO, would be hurt most by zeroing out tariffs. They're demanding lower barriers in rich nations to their farm exports, which the U.S. plan doesn't address.

WHO WON IN THE PORT PACT?

WEST COAST PORTS WILL REMAIN open for the next six years, thanks to a tentative

HEADLINER: ALAN KAY

HP'S PARC RANGER

CAN THE MAN WHO SAID "The best way to predict the future is to invent it" give Hewlett-Packard a lift? HP, which continues to reinvent itself following its acquisition of Compaq Computer, certainly hopes so. On Nov. 26, computer scientist Alan Kay, one of the founders of Xerox' famed Palo Alto Research Center (PARC), signed on as a senior fellow at HP Labs.

The 62-year-old Kay will work with other HP scientists to develop software for computing devices and other applications. His biggest challenge may be duplicating his early suc-

cess. In the 1960s, he and others designed ARPAnet, the forerunner of the Internet. He also created Dynabook, an early prototype for a tablet-like PC, and led development of the graphical user interface. Kay's career also included stints at Atari, Apple, and Disney. Skeptics note that Kay's big-picture ideas haven't always translated into commercial success, but Hewlett-Packard is hoping that he will be able to develop profitable applications that boost its chances of becoming a one-stop shop for equipment and software.

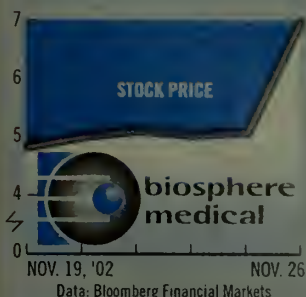
Cliff Edwards



CLOSING BELL

BEADWORK

Shares of BioSphere Medical soared 38.9% on Nov. 26, to \$7, after the FDA approved its Embosphere Microspheres: tiny acrylic beads that serve as a nonsurgical alternative to a hysterectomy in treating uterine fibroids. The beads cut off the blood supply to the fibroids, essentially starving them to death.



agreement reached by long-shoremen and the shipping lines. The apparent accord came after months of bitter negotiations, a lockout, and a federal-court order to keep the ports open for 80 days under the Taft-Hartley Act. The key tradeoffs: Shipping companies get to introduce more efficient cargo-tracking technology that will result in the loss of 400 jobs. But the remaining 10,000 dockworkers will receive higher salaries and pensions—and they'll get to control the new technology. The Pacific Maritime Assn. says the pact will cost shippers more than \$1 billion.

CENDANT: AGAIN, THE SCENT OF SCANDAL

ACCOUNTING QUESTIONS ARE again dogging travel and real estate giant Cendant. On Nov. 25, the company's stock fell 3.5%, to \$12.26, after re-

ports that the SEC is looking into deals between Cendant and real estate Web operator Homestore. A Cendant spokesman says the SEC didn't inquire about certain transactions between the two companies last summer but didn't take any action. Homestore restated earnings for 2000 and 2001 after acknowledging the company had improperly booked \$160 million in revenues. Cendant said in a statement that "there is no basis for, nor is there any indication of, an investigation by the SEC or others."

ET CETERA...

- US Airways Group will cut 2,500 jobs, or 7.1% of its workforce.
- Peregrine Systems' ex-assistant treasurer Ilse Cappe pleaded guilty to bank fraud.
- American Airlines' domestic capacity will fall 3.3% by March, 2003.



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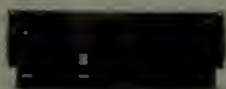


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EDITED BY RICHARD S. DUNHAM

SENATE MODERATES SPEAK SOFTLY AND CARRY A SMALL STICK

Senate moderates, goes an old Washington saying, temper the ideological excesses of whichever party is in power. And since the Republican sweep in November, that saw has been bandied about town more than ever. There's only one problem: This "truism" isn't true.

Certainly, a bipartisan group of about 10 lawmakers has the potential to be influential. If moderate Democrats such as John B. Breaux of Louisiana and E. Benjamin Nelson of Nebraska teamed up with a half-dozen similarly inclined Republicans, they could block any legislation they found too extreme. But the moderates have shown neither the temperament nor the cohesiveness to obstruct the conservative agenda. As a result, President Bush's wish list—from tax cuts to right-leaning judges—is likely to zip through Congress largely intact. "The idea that they can tie up the Senate and force change is dubious," says James A. Thurber, professor of government at American University. "They're not in the Republican leadership, they don't control many of the committee chairs, and that's where the agenda is shaped."

The moderates' reluctance to confront their conservative colleagues will be felt most acutely on taxes. Despite concerns about the growing budget deficit, the centrists are unlikely to slow White House attempts to make the 2001 tax cuts permanent and accelerate some rate reductions. "They voted for the tax package once, and they'll do it again," says conservative activist Grover G. Norquist, president of Americans for Tax Reform.

The centrist GOP senators—including Olympia J. Snowe and Susan M. Collins of Maine, Lincoln D. Chafee of Rhode Island, and Peter G. Fitzgerald of Illinois—insist they're not doom-mats. They're hoping to safeguard education and health programs from deep budget cuts. And they will try to ensure that less-well-off Americans share in any tax-cut bonanza, in

particular by making the child tax credit permanent.

While the centrists will be satisfied with small fiscal victories, they are talking big on the environment. They are promising to go to the mat to make sure that new energy legislation does not include drilling in the Arctic National Wildlife Refuge. "I'd like to see the party follow the tradition...[of] Theodore Roosevelt," says Fitzgerald. "He was our first environmentalist President, and he was a Republican."

Nice thought, but some colleagues are convinced the centrists don't have the gumption to fight. "They take a three-step approach: ineffective protest, abject surrender, and then denial," fumes liberal Representative Barney Frank (D-Mass.).

There's a reason Frank and others are so steamed. It took only 15 days after the election for the centrists to provide the pivotal votes to pass homeland security legislation, despite concerns about provisions tucked in by the House GOP. One effectively limits the liability of drug companies whose vaccines are alleged to cause autism in children. Another allows companies to bid on homeland security contracts even if they have moved offshore to dodge taxes.

Instead of insisting that the House strip out the provisions, the moderates allowed them to become law after private assurances from Senate Majority Leader Trent Lott (R-Miss.) that the offending items would be excised next year.

However, House Majority Leader Tom DeLay (R-Tex.) says he's under no such obligation. The centrists now find their credibility on the line. "I have a call in to Trent about this," says Collins. "I got what I thought was an ironclad promise."

That kind of lament is not what moderates had in mind when they boasted of forging a "third way." Instead of curbing ideological excesses in the new Congress, they are in danger of looking like little more than patsies for the Right.

By Alexandra Starr



CHAFEE: *Too obliging?*

CAPITAL WRAPUP

DYNASTIC DELUSIONS

► President Bush's midterm triumph—combined with brother Jeb's landslide reelection in Florida—has some Republicans dreaming of extending the family dynasty. But before George W. thinks too seriously about handing the White House keys to Jeb, he should ask his party's rank and file. According to a Nov. 19-20 Fox News/Opinion Dynamics Poll, just 20% of Republicans want the Florida governor to seek the top job in 2008. Only 9% of Independents say yes to Jeb for Prez.

NO MORE MR. NICE SPEAKER

► He may look warm and cuddly, but House Speaker Dennis Hastert (R-Ill.) is tightening his control over committee chairs. New GOP caucus rules will prevent panel bosses from filing bills without approval from a 17-member steering committee dominated by social conservatives and budget hawks. Chairs who push bills without permission risk losing their plum posts. "It's a shot across the bow" of the 13 powerful "cardinals" who head spending subcommittees, says a top GOP aide.

WHITHER THE LAWYERS?

► Another sign of Republican dominance in Washington: Come January, there will be more businesspeople than lawyers in Congress. That's a huge shift in the past three decades. Between 1970 and 2002, the number of attorneys elected to the House has slipped from 242 to 160, according to *Congressional Quarterly*. Meanwhile, the number of executives, bankers, and entrepreneurs has grown to 162, a 24% increase since the 1994 Republican takeover.

GREATER CHINA

**The mainland is absorbing
the economies of Hong Kong and Taiwan
faster than you think. How will
this new superpower affect the world?**



A

decade ago, local farmers were baffled why the city of Shanghai had decided to extend the No.2 subway line across the Huangpu River all the way to their township of Zhangjiang, at the time just a marshy expanse of rice fields and fish-filled canals. Many electronics experts, meanwhile, regarded official predictions that this site would become a high-tech park brimming with state-of-the-art semiconductor plants as laughable. The most likely investors, Taiwan's big chip manufacturers, were forbidden by their government from transferring such sophisticated facilities and technology to the mainland.

Yet with stunning speed, this vision is becoming reality. Last year, Semiconductor Manufacturing International Corp. (SMIC), headed by former Taiwanese chip executives, opened a \$1.5 billion silicon wafer fabrication plant. SMIC is preparing to build another one. Right next door, a joint venture headed by Taiwanese electronics tycoon Winston Wong has opened another sophisticated wafer fab. Taiwan Semiconductor Manufacturing Co., the world's leading contract chipmaker, is planning a wafer fab nearby, too. These are among 70 electronics companies that now have facilities in the 9.7-square-mile zone, which also hosts research labs for Sun Microsystems, LG, and Sony. A 400-researcher lab by General Electric on the way. Indeed, predictions that Zhangjiang will someday rival Taiwan's renowned Hsinchu Science-Based Industrial Park no longer seem outlandish. "We are just at the initial stage," says Dai Haibo, CEO of the company that manages the zone. As more labs arrive, "we will be like Hsinchu combined with Silicon Valley," says Dai, who expects Zhangjiang's workforce to reach 200,000, in a decade.

Zhangjiang is but one focal point of one of the biggest economic mergers in history—as profound as the integration of Europe or North America. The concept of a Greater China has

been developing since the 1980s, with the mass influx of manufacturers from Hong Kong, and then Taiwan, to the southern China coast soon after Beijing opened its doors. But in the past year, with China's entry into the World Trade Organization, the industrial unification of the three economies has hit warp speed and is spreading deep into the mainland. Political barriers to investment in once-strategic industries such as semiconductors, oil, and banking are crumbling, infrastructure systems are fusing—and Hong Kong and Chinese officials are collaborating on regulatory affairs.

Clearly, Hu Jintao, who was just named General Secretary of China's Communist Party at Beijing's 16th Party Congress, inherits the stewardship of an economy that is vastly

different from when Jiang Zemin took full control in 1997, as China was just beginning to seriously whittle down the state sector. This is also an economy that is developing with less and less guidance from the center, and that often makes the tension-filled politics of Taiwan-China relations seem like a sideshow. Beijing is starting to realize that its goal of absorbing Taiwan is best served by letting the process proceed—not by hurling threats against Taipei. "The general policy now is to be confident and patient," says Wang Yong, executive director of Beijing University's Center for International Political Economy Research. "We should let the forces of integration play a larger role in determining the shape of cross-strait relations."

A few manifestations of this accelerated convergence:

- In the past two years, the number of Taiwanese officially living on the mainland has swelled from 300,000 to 500,000. And some estimates run much higher. Several thousand Taiwanese students are pursuing degrees in China rather than at U.S. universities.
- This year, China will pass the U.S. as Taiwan's biggest export market. Within the next year or two, when approval for direct shipping and air links are expected, cross-strait trade will surge even more.
- China has passed Taiwan as the world's No.3 maker of

SPECIAL REPORT



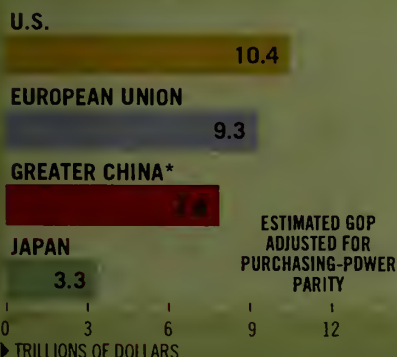
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CHINA: THE NEW MATH

How big is the economy of Greater China? By adjusting its \$1.7 trillion GDP for purchasing-power parity—which accounts for differences in price levels—it's a giant.

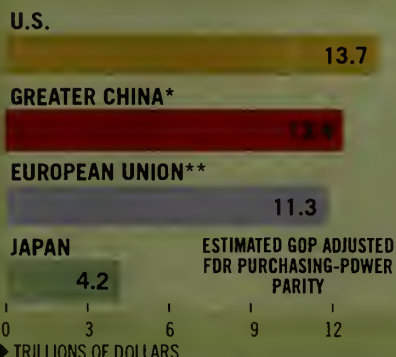
ALREADY A PLAYER...

2002



...GROWING FAST...

2007



...AND TRADE IS BOOMING



*INCLUDES CHINA, HONG KONG, AND TAIWAN

**CURRENT MEMBERS ONLY

Data: Global Insights Inc., Goldman Sachs & Co.



information-technology products. But many of the benefits flow to Taiwan companies, who control 70% of the out-

put. China has overtaken Taiwan as a maker of desktop PCs, optical drives, and liquid crystal displays. The share of Taiwanese notebook PCs made in China has leaped from 4% to 30% since early 2001.

- In a bid to maintain the Pearl River Delta's competitive edge over other parts of China, business and government leaders in Hong Kong and Guangdong are discussing a \$1.9 billion bridge linking Hong Kong to Zhuhai and Macao, rail and subway links, easier border crossings at Shenzhen, and ways to coordinate the services of the Delta's five airports.

- Hong Kong's role as an international capital window for China is growing. Quicker regulatory approval prompted Bank of China (Hong Kong) to float its initial stock offering in Hong Kong rather than New York, while dozens of other Chinese companies have listed on Hong Kong's new second board aimed at startups.

The impact of Greater China as an exporter is being felt worldwide. Its share of total exports has gone from 6.9% to 9.6% in just four years, surpassing Japan, according to the World Bank. By 2007, it should reach 13.7%. Also by that time, as the mainland and Taiwan open their markets to comply with WTO commitments, Greater China should pass \$2 trillion in exports and imports, excluding the trade between the three economies, estimates Goldman Sachs & Co. (Asia). That would make it nearly twice as big as Japan as a trading power and two-thirds the size of the U.S. Measured in terms of purchasing power, the World Bank estimates Greater China will overtake the European Union in five years, with a combined gross domestic product of \$12 trillion. By that yardstick, it would be nearly triple the size of Japan. The market capitalization of the bourses of Hong Kong, China, and Taiwan could challenge Tokyo's \$2.1 trillion by then.

You can expand this concept of Greater China even further if you include the huge populations of overseas Chinese who still consider the mainland home and increasingly are returning to start businesses there. Of the more than 400,000 Chinese who have studied overseas in the past two decades, some 140,000 have moved back, bringing with them advanced degrees, Silicon Valley experience, and venture capital. Shenzhen Mayor Yu Youjun reports that his city already has 300 companies run by returnees. More than 1,000 overseas-educated Chinese move there each year.

Stretch the notion a bit more, and you have China as the hub of North Asia. Ex-McKinsey & Co. consultant Kenichi Ohmae argues that what's emerging is a United States of Chi-

na, with dozens of growth zones essentially renting themselves out to foreign investors. He estimates 100,000 South Koreans live in cities such as Qingdao and Tianjin; some 4,000 Japanese companies have operations near Dalian. Singaporean companies also are a big source of capital.

The real architects of this growing economic colossus are the entrepreneurs of greater China and the officialdom of cities such as Shanghai, Chongqing, Shenzhen, Dongguan, and Hong Kong. They have spent two decades creating networks of influence and putting down roots, advantages that will be extremely difficult for other foreigners to match. Equally important, these players are providing China with the managerial and financial expertise needed to compete in the world.

Why is this process speeding up? The biggest driver is China's economic reforms, now anchored by its entry into the WTO. Another is the ever-deeper integration of Hong Kong since the departure of the British in 1997. Security regulators and monetary authorities from Hong Kong and Beijing now work closely with each other. Meanwhile, mainland companies such as Bank of China, which used to be shadowy presences in Hong Kong now use it as a base to learn international management standards. InvestHK, a Hong Kong government body, has set up three teams dedicated to bringing mainland companies to the ter-

WHERE THE ACTION IS

CHONGQING: Nearly \$200 billion in investment is expected over the next decade, spurred by the development of the West and determined wooing of Hong Kong, Taiwanese, and Japanese investors.



DONGGUAN: The heart of the Pearl River Delta and the world's biggest light-manufacturing base. Dominated by Hong Kong and Taiwan companies.

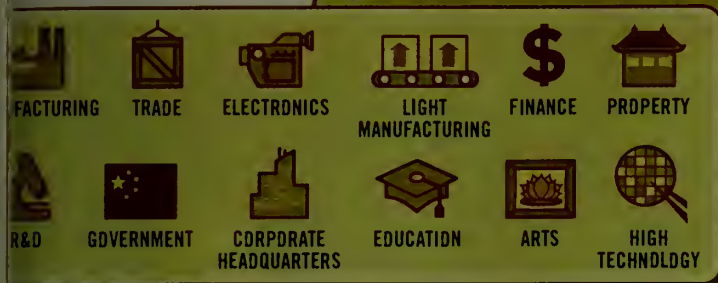


SHENZHEN: A rising R&D and service center and home to 2,400 Taiwanese-owned factories. Better transit and a more open border will help it merge with Hong Kong.



SILICON VALLEY: Greater China's gateway to advanced technology. Many U.S.-based scientists, engineers, and executives born in China are returning home to found tech startups.





BEIJING: The center of government, education, and many multinational headquarters.



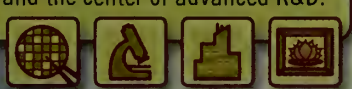
KUNSHAN: Home to some 30,000 Taiwan emigrants—with their own school, country clubs, and villas. Production and R&D base for Taiwan's biggest companies.



SHANGHAI: The future hub of finance, corporate headquarters, and education for the entire region. Also a rising regional center for semiconductor production.



TAIPEI: Base for Taiwanese industrial companies controlling most of China's electronics output. A hub of Chinese pop culture and the center of advanced R&D.



KAOHSIUNG: Shipping magnates expect explosive growth at Taiwan's biggest port when direct transport links to the mainland begin.



HONG KONG: The New York of Greater China. The region's leading financial, trade, and business center. A window to the world for mainland corporations that raise billions in capital.



After years of trying to keep its distance, deflation-ravaged Hong Kong is also looking to the mainland as a savior. A few years back, Hong Kongers were willing to commute by hydrofoil or bus to factories in the Pearl River Delta, but few wanted to live on the mainland.

Now, they're fighting for jobs there. Thousands flocked to a mainland job fair in Hong Kong early this year. Hong Kong property magnate Vincent Lo says he has to turn down transfer requests from all but his most highly skilled Hong Kong staff.

Calmer relations across the Taiwan Strait are also helping. Just 18 months ago, when longtime opposition candidate Chen Shui-bian took office as President, Beijing

lashed out at every defiant move by Taipei. Lately, China has downplayed Chen's remarks on Cross-Straits issues. It has also signalled it may be willing to consult Taiwan on trade issues, and has toned down demands that Taiwan accept its "One China" principle before having such contacts.

Both sides clearly would benefit from full-fledged cooperation. Taiwan still bans imports from China of thousands of products, from car engines to most farm goods. Worse, the lack of direct transport links, which turn a one-hour flight into a day-long ordeal transiting through Hong Kong, add 60% to freight costs. Removing all such barriers would add 3% to the economic growth of both Taiwan and China by 2011, calculates George Mason University economist Zhi Wang. It also would boost their combined exports by \$10 billion

a year. "Political relations can slow integration," says Acer Inc. Chairman Stan Shih, who has set up factories across the mainland. "But economic movement just cannot stop."

Talent from Taiwan and Hong Kong has been pivotal to China's ability to maintain annual growth rates of at least 7%. It plays a key behind-the-scenes role at advanced plants and research labs provided by multinationals such as Cisco Systems, Ford Motor, Nokia, Sony, and Motorola. "All of our Chinese plants are being built with Taiwanese managers," says Gerard J. Kleisterlee, CEO of Royal Philips Electronics, which

itory, and China's foreign trade ministry has begun bringing delegations of private mainland entrepreneurs interested in opening Hong Kong offices. "For years, Hong Kong's main function has been to send capital to China," says Li Luoli, president of the China Development Institute in Shenzhen. "Now, this role is to help Chinese companies go abroad."

has cut its Taiwan workforce from 12,000 to 4,000 in the past few years as it shifted production to China.

You get a glimpse of the new China at Shanghai's Xintiandi. Just a few years ago, its rows of tile-roofed *shikumen*, or stone houses, were crumbling relics of a colorful past. In the mid-19th century, when this 128-acre area was the heart of the French Concession, Chinese from surrounding provinces crowded here to escape the Taiping Rebellion. Decades later, when Shanghai was Asia's top commercial hub, the area boasted clubs and nightspots where young Chinese mingled with Europeans or plotted revolution. After the 1949 Communist victory, the prosperous Chinese in Shanghai scattered abroad.

Now, every night, ethnic Chinese from Taiwan, Hong Kong, and the U.S. mingle with the mainland's nouveaux riches in the painstakingly renovated *shikumen*, home to the city's hippest restaurants, boutiques, and bars. Renowned painter Chen Yifei owns a stylish clothing shop, and one of Taiwan's biggest food companies owns the local Starbucks Corp. franchise. Tycoon Vincent Lo, born and bred in capitalist Hong Kong, is heading redevelopment of Xintiandi into a \$3.5 billion complex that will include high-end apartments and a 68-story building with a luxury hotel. In a twist of irony, the First Congress Hall, where the Chinese Communist Party convened its first meeting in 1921, sits amidst the hubbub, newly renovated as a tourist attraction.

Xintiandi shows the consumer side of integration. Other economic hotspots offer glimpses of how far industrial integration has come. The steamy Pearl River Delta is rich with such examples. The sprawling campus of Taiwan's Wistron Corp. in Zhongshan, an electronics contract manufacturer spun off from Acer, looks as if it was transplanted from Hsinchu, Taiwan's technology heartland. The neatly manicured grounds include dormitories with basketball courts for its 2,800 workers, a 200-engineer software-development lab, and three factories making desktop PCs, set-top boxes, DVD players, and PDAs—almost all for export. Soon, the Zhongshan facility will make Xbox game consoles for Microsoft Corp.

A chief lure of the region is the mass transfer of Taiwan's components industry. "Guangdong Province has the most developed component-supply base in the world," says Jeff Tsao, general manager of the Wistron plant. Only two

years ago, at least 80% of the components used in Taiwan-owned factories in South China came from Taiwan. Today more than half are sourced locally, and the share is growing fast, estimates Beijing-based economist Andy Rothman of CLSA Emerging Markets. Even executives who visit the region frequently are stunned at the pace of change. During a recent visit to his company's factory in Shenzhen, James E. Sacherman, chief marketing officer for contract-manufacturing giant Flextronics International Ltd., says he asked his staff there if he could buy certain cables locally. He was told there were now 300 suppliers in the immediate area. "It's all

RICHARD CHANG

TAIWAN'S SILICON INVASION

In 1999, Richard Chang could have easily retired. He had just sold his fledgling Taiwan chip company to industry giant Taiwan Semiconductor Manufacturing Co. for \$515 million. But Chang, who spent 20 years at Texas Instruments before starting his own business, wasn't ready to slow down. He saw a wealth of opportunity in the growing integration of the economies of Greater China. Now, tapping Taiwan expertise and drawing from the pool of skilled workers on the mainland, Chang wants to help China build a world-class chip industry. "We like to have [Taiwanese and mainlan-

ders] work together," says Chang, 54. "We can complement each other."

Chang is betting that his team will learn quickly. His Shanghai-based Semiconductor Manufacturing International Corp. (SMIC) opened its first chip-making plant last year, and it is launching a second in December—with plans to build a third, in Beijing, in a few years. All told, Chang has raised more than \$1.5 billion from a roster of investors that includes Goldman Sachs, H&Q Asia Pacific, and Toshiba. Although the company is still a fraction of Taiwan Semiconductor's size, SMIC is the most advanced chipmaker in China

today and has won big customers such as Fujitsu, and partnerships with Toshiba and Chartered Semiconductor.

SMIC's launch has spooked many Taiwanese, who fear they are losing their edge in a vital industry. Yet Chang, who was born in Nanjing but moved to Taiwan with his parents as an infant during the Chinese civil

A DEVELOPER DRIVES INTO THE HEARTLAND

back in the mid-1980s, many of Hong Kong's moneyed elite were cashing in their chips and moving in fear that a Chinese takeover would destroy the British colony. But Vincent Lo didn't budge. Indeed, he decided the time was ripe to bet on the mainland. The son of a prominent Hong Kong developer, Lo had set up his own development and building-materials company in the early '70s. Then, in 1982, he launched a \$23 million venture with the Communist Youth League to build a hotel in Shanghai.

That investment is now blossoming into a multibillion-dollar portfolio of commercial and residential projects. Lo, much like anyone, has set out to redevelop urban China by building developments that reflect the country's unique

PEOPLE THOUGHT I WAS CRAZY"

mainland assets may grow 10% of his holdings

history while embracing modern planning. Today, half of the assets of his Shui On Holdings Ltd. are on the mainland—mostly in Shanghai real estate—and he expects that to grow within two years to 80%. "A lot of people thought I was crazy," says Lo. His answer: China "will propel the whole world's growth."

Lo's crown jewel is the glitzy Xintiandi project in Shanghai. The two-year-old development mixes commercial space with dozens of restaurants and boutiques in a historic neighborhood. The final price tag by the end of the decade: \$3.5 billion. Xintiandi has been such a success that Lo is now backing a similar project in Hangzhou, 100 miles south of Shanghai.

Now, Lo is in the vanguard of the next big move for Hong Kong money: the investment drive deep into China's vast heartland. Four years ago, Lo founded a group to spur economic development in the Yangtze River basin, stretching from Shanghai to Chongqing.

This year alone, the indefatigable 54-year-old developer has made three trips to the U.S. and Europe to drum up investment for the region. "The opportunities are in the interior," he says.

Lo is backing that hunch with big money. He and his partners have invested more than \$100 million in a string of formerly state-owned cement plants in Chongqing, Guizhou, and Sichuan in a bid to profit from rapid growth in China's west. Local officials welcome the tax revenues, the jobs, and a new way of looking at things. Through his investment, Lo "solved financial problems and installed a modern management system" at the Di Wei cement factory, says Guo Ruqi, the Communist Party secretary in Jiangjin, a Chongqing county with 1.5 million residents 25 miles south of the city center. Part visionary, part cement salesman: It's an unusual combination. But Lo is doing his bit to modernize China.

By Mark L. Clifford in Chongqing

the same guys I used to visit in Taiwan," he marvels. "All of their friends are there, too."

The transformation is just as visible in Kunshan in Jiangsu province, a region that will soon surpass Taiwan in production of notebook PCs. Many of the 30,000 Taiwanese residents of Kunshan are buying homes in the city's vast villa complexes and sending their children to

a Taiwanese-run school. Tree-lined Tinglin Road has so

many Taiwanese-owned restaurants and clothing boutiques that locals refer to it as Taipei Road. Chang Hwa Commercial Bank Ltd. has just opened an office. Hundreds of Taiwanese companies—including Acer, Compal, Hon Hai Precision Industry, President Foods, and Nanya Plastics—have invested some \$7.5 billion in the area.

While Taiwan is replicating its tech empire on the mainland, some of Hong Kong's pioneering companies are pushing much deeper into the interior. "Now, they are moving very dramatically into middle China, with western China as the next great push," says Michael L. Ducker, FedEx Corp.'s express international executive vice-president. To meet the shipping needs of Hong Kong and other companies, Ducker

war that ended in 1949, doesn't think the mainland's nascent chip industry is a threat: He sees the two sides giving each other the boost they need to build a stronger whole. Today, almost 20% of SMIC's 3,100 employees—including many top engineers—are from the island. As SMIC and other mainland foundries grow, Chang says Taiwanese chip-design houses are likely to follow.

There's more to Chang's motivation than business. "The Lord wants us to come to China and share God's love with the Chinese people," says Chang, a devout Christian. That sort

of talk initially made the Communist cadres "feel a little awkward," he admits. As the two sides have gotten to know each other, Chang says, Shanghai officials have become more comfortable with both his business and religious goals. His local partner, state-controlled conglomerate Shanghai Industrial, has helped him make crucial connections and win tax breaks. And Shanghai officials even found space near SMIC's factories for Sunday services that attract some 150 worshippers, both mainlanders and Taiwanese. That's a sure sign that when it comes to Taiwanese businessmen on the mainland, the comfort level of Chinese officials is rising every year.

By Bruce Einhorn in Shanghai

BETTING BIG ON CHINA

SMIC's Chang is bringing Taiwan's knowhow to the mainland





says FedEx plans to open offices in 100 new Chinese cities over the next five years. Besides developing Shanghai's Xintiandi district, for example, Vincent Lo has bought up cement plants in Chongqing and the provinces of Sichuan and Guizhou. In October, Lo led a delegation of more than two dozen businesspeople to look for opportunities in Chongqing.

Perhaps Hong Kong's most crucial role, though, is as Greater China's Wall Street. The Bank of China is making its Hong Kong affiliate a laboratory for good banking practices in one of Asia's most sophisticated and well-regulated capital markets. The Industrial & Commercial Bank of China has set up a merchant-banking arm in the city.

China also is tapping Hong Kong government talent. Former top Hong Kong Securities & Futures Commission (SFC) official Laura M. Cha has taken a staff job in Beijing at the China Securities Regulatory Commission (CSRC). She is helping draft reforms that, among other things, will permit foreign investment in China's publicly traded state enterprises. Former Hong Kong SFC head Anthony Neoh is the CSRC's senior adviser and helped push through new proposals to allow foreign portfolio managers to buy Chinese stocks. "China needs Hong Kong because it can't manage its own pool of domestic savings," of some \$500 billion, says Brookings

Institution economist Nicholas Lardy. "This help in building China's financial infrastructure is hugely important."

Financial industries also are melding as Beijing gradually opens its banking sector to foreigners. Last December Hongkong & Shanghai Bank bought a stake in Bank of Shanghai. And mainland-born Weijian Shan, who heads U.S.-based Newbridge Capital's office in Hong Kong, is leading negotiations to buy a stake in Shenzhen Development Bank Ltd. If the deal closes, Newbridge would be the first foreign institution to control a mainland bank.

In yet another sign of how integration is breaking down barriers, the banks of Taiwan and China are starting to come together. In the past year, Beijing has allowed several Taiwanese banks to open offices, while China's Shanghai Pudong Development Bank and Fujian Industrial Bank have applied to do business in Taiwan. Even major government-owned companies are starting to cooperate in ways unimaginable just a year ago. Taiwan's China Petroleum Corp. is jointly exploring for reserves with Beijing's China National Offshore Oil Corp., and Taiwan's China Airlines has just won approval to buy a stake in the mainland's China Cargo in anticipation of new business with the establishment of direct flights.

There are potential hazards to full-fledged economic integration. As Taiwanese and Hong Kong companies become

YU YOUJUN

A MODERN MAYOR



OPENING UP

Yu encourages overseas investment in Shenzhen

Shenzhen Mayor Yu has become a pivotal player in China's integration with Taiwan and neighboring Hong Kong. Energetic and open-minded, 49-year-old Yu is one of a growing breed of Communist Party cadres guiding China's transformation into a modern market economy. After taking the

helm in Shenzhen in 2000, Yu quickly began pushing to open state-dominated sectors to foreign investment. For instance, he's backing Newbridge Capital's proposed acquisition of Shenzhen Development Bank Co. And he encourages overseas investors to buy stakes in enterprises that provide gas, water, and food in Shenzhen. "We are a pilot city for carrying out reforms," Yu explains.

Yu also has played a key role in wooing Taiwanese investment. Last year, he traveled to Taipei on a promotion tour—

the first trip across the Taiwan Strait by a mainland mayor since 1949. Some 3,400 Taiwanese companies already have invested \$4.7 billion in Shenzhen factories, making everything from computer monitors and cell phones to cables and keyboards. Now, Taiwanese companies are tapping China's vast pool of cheap and able engineers.

Yu's long-term agenda is ambitious. He wants to more thoroughly link Shenzhen to Hong Kong by improving snarled border crossings, developing joint research centers with tech institutes in the city, and meeting regularly with regional officials. As Yu sees it, Hong Kong will continue to lead the mainland in financial and information services, while Shenzhen will be the production and engineering base for light-industrial goods, software, and advanced electronics.

High-gear capitalism may seem like an odd agenda for a former propaganda chief. But during Yu's years in the Guangdong government, the province was regarded as the most progressive in China. Now, he sees himself serving his country by building a stronger Shenzhen and tying it to Hong Kong and beyond. "If we combine our strengths, we can become a high-tech and service base for all of Asia-Pacific," says Yu. Think of that as propaganda for the new China.

By Dexter Roberts in Shenzhen

Yu Youjun heads China's most open city, a haven for Hong Kong and Taiwan electronics makers. He's in charge of a rapid reform program that serves as a model for the entire mainland. And even though he has a PhD in Marxist studies—and served as the Communist Party's propaganda chief for Guangdong Province—Yu studied business at Zhongshan University and has long backed China's opening to the world.

This résumé helps explain why Shen-

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more dependent on China for their manufacturing, components, engineering, and markets, they will become more vulnerable to a political or financial crisis there. Both remain distinct possibilities: China's banking system is in precarious shape, with an estimated \$700 billion in bad loans. Millions of angry workers with scant pensions are losing their jobs at state-owned industries, and labor protests are breaking out. "In a crisis, Chinese labor could become as destabilizing a force for the world economy as oil prices," says Ted Dean, managing director at information-technology consultant BDA (China) Ltd. in Beijing.

There also is the possibility that political tensions could once again sour Taiwan-China relations. It was only two years ago, after all, that China implied it was ready for war if Taipei didn't start seriously negotiating to rejoin the mainland. Taiwanese political leaders could provoke Beijing again by taking steps toward independence. As for Hong Kong, the worry is that ineffective leadership will squander many of its advantages—a strong rule of law, good civil service, free media, and tough anti-corruption stance—and blur the distinction with the mainland.

Still, there is a more encouraging way to view the Chinese convergence. As more and more citizens of Taiwan, Hong Kong, and China live, work, and study together, they increasingly will see themselves as part of one entity. This attitude clearly is discernible among the Taiwanese students

BEIJING SUBWAY

Taiwan pop music is big on the mainland



who choose to study at Chinese universities. Taiwan-born Wang Jikang, 28, who is pursuing a master's degree in law at Shanghai's Fudan University, says he decided against a U.S. school because opportunities are brighter in China. Most of his Taiwanese classmates feel the same, he says. "Taiwan doesn't have an economic future outside the mainland," he adds. But because of Taiwan and Hong Kong, the mainland has a much brighter future as well, one that will be shaped increasingly by the best and brightest of all three regions.

By Dexter Roberts in Shanghai and Mark L. Clifford in Chongqing, with Bruce Einhorn in Taipei and Pete Engard in New York

LIU MINGKANG

A FORCE FOR FINANCIAL REFORM

Few Chinese know how far the country has come in the past 35 years better than Liu Mingkang. For much of the Cultural Revolution from 1966 to 1976, Liu was persecuted because he was the son of a law professor, and he was forced to toil as a peasant in rural Jiangsu Province. He taught himself English at night with the help of a shredded textbook he had pieced together. After a brief stint as a steelworker, Liu landed a job at Bank of China in 1979, when Deng



CLEARING THE FOG

Liu's priority for Bank of China: Transparency

Xiaoping ushered in his reform. He quickly rose in the ranks and even made time to earn an MBA at City University of London.

These days, as chairman of Bank of China, Liu is perhaps the most forceful advocate of the modernization of China's financial industry—and of its integration with capital markets in Hong

Kong and beyond. Liu took the helm of China's second-biggest bank in 1999, and he has steered it through rough waters in the wake of a corruption scandal that embroiled his predecessor. He persuaded Premier Zhu Rongji to let him list shares of its 344-branch Hong Kong operation—which accounts for most of the bank's profits—on the Hong Kong Stock Exchange. Before he could do the initial public offering, Liu oversaw a tricky merger of 13 different banks and financial institutions that were under the bank's umbrella—a delicate exercise that involved intense negotiations with Hong Kong regulators. Liu figured the July, 2002, IPO would force the bank, long known for its secrecy and bloated bureaucracy, to become more transparent and to adopt international management standards. Before the listing, "we did

not have responsibility or accountability," says Liu, 56. "It's a story of good governance."

Bank of China's example, Liu hopes will inspire other banks to improve. Already, the Hong Kong affiliate has become a place where bright young financial talents from China are learning modern risk-management techniques that can be transferred to the mainland. A separate investment banking operation, Bank of China International recently joined a Morgan Stanley-backed venture as the only foreign institution licensed to underwrite international stocks and bonds in China. Because it must now answer to foreign capital markets, Liu also hopes Bank of China will be better able to resist government pressure to lend to politically favored companies.

Liu maintains that standards are improving. "China is changing very fast," he says. It will be up to determined executives such as Liu, equally at ease in the inner circles of Beijing and tony Hong Kong office suites, to build the sophisticated financial sector that Greater China needs.

By Mark L. Clifford in Hong Kong

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EDITED BY ROSE BRADY

VENEZUELA: WILL THIS SHOWDOWN TOPPLE CHAVEZ?

Tension is rising palpably in Caracas as the clock ticks down to Dec. 2, the day that opponents of Venezuela President Hugo Chávez have declared yet another general strike aimed at forcing him to hold an immediate referendum on his rule. It would be the fourth strike in less than a year in the confrontation between Chávez and a loosely knit coalition linking representatives of opposition political parties, labor, business, the military, and the Catholic church.

What makes this strike different? Unlike previous one-day actions, Chávez' leading opponents aim to shut the country down for a minimum of 72 hours. That means the strike would last through Dec. 4, the deadline for the country's National Electoral Council (CNE) to rule on the opposition's petition for an immediate referendum on Chávez' presidency. Almost no one expects Chávez to agree to a vote even if the CNE backs the petition. That's why most Chávez opponents want a strike no matter what the CNE does, and some call for an indefinite walkout until the President firmly agrees to the referendum or resigns. "We are absolutely sure that [this strike] will be a lot more forceful than other strikes," Antonio Ledezma, a top opposition leader, told a Nov. 21 press conference.

The two sides are playing a complicated game. According to Venezuela's constitution, a binding referendum on Chávez' presidency cannot be held until halfway through his term—or next August. A defeat would trigger new elections. Even though Chávez has indicated he might accept a vote then, the opposition wants a non-binding referendum now. They feel Chávez would lose so badly he'd have to resign. But the opposition is risking its own popularity by calling a strike when the economy is reeling. The country's gross domestic product has contracted 6.4% this year, largely because of the 48% devaluation of

Venezuela's currency. The economy will be hammered if state-owned *Petróleos de Venezuela* joins an extended walkout.

Meanwhile, Chávez, whose popularity has fallen from 80% in 1999 to 30% today, is playing hardball. He recently ordered the army to take over the city police force in Caracas, where Mayor Alfredo Peña is a Chávez opponent. Now, armed soldiers guard police stations, and the army has seized the police officers' rifles. "The criminals are better armed than [we

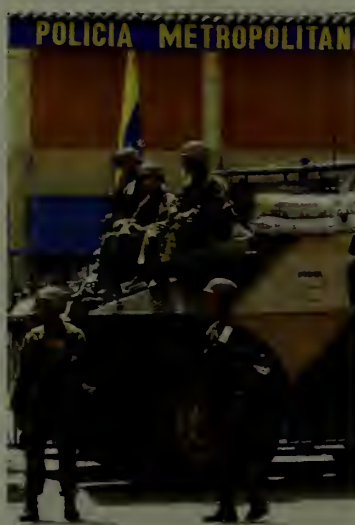
are] now," grumbles police Captain Carlos Guerra. Chávez can also call on the National Guard and on radical supporters known as Bolivarian Circles. "We are sure that [Chávez] is going to develop repressive and violent activities against the opposition," says William Dávila, another opposition leader.

Frantic efforts are under way to find a peaceful solution, quietly backed by the Bush Administration. César Gaviria, Secretary General of the Organization of American States (OAS), wants the opposition to accept an August referendum, and use the time until then to hash out a program and agree on candidates to run against Chávez. A gradual transition "could be positive for the country," says Peter F. Romero, former Assistant Secretary of State for Western Hemisphere Affairs.

For now, Chávez and the opposition are still digging in. The likely winner for now is

Chávez, since he has the firepower and can claim to have the constitution on his side. The opposition may be hoping for a "people-power" revolution, wherein millions take to the streets, forcing him to resign. If that doesn't materialize, the opposition will be left with few choices other than waiting until Chávez must allow a vote on his presidency. Losing this month's battle may be a prelude to winning next year's war.

By Stephen Ixer in Caracas, with Stan Crock in Washington



THE ARMY: Policing Caracas

GLOBAL WRAPUP

A KEY VOTE IN INDIA

► Voters in the Indian state of Gujarat are bracing themselves for crucial elections set to take place on Dec. 12. Earlier this year, the state was the scene of India's worst violence between Hindus and Muslims in a decade, and violence has already marred the campaign. The ballot is an important test for the ruling Bharatiya Janata Party (BJP), which is facing a stiff challenge from the opposition Congress Party. The BJP has lost a dozen state elections in recent months and only gov-

erns in four states. Congress now runs 14 states.

Losing Gujarat to Congress would be a major blow to the BJP. Such a defeat would further damage its chances of maintaining power at a national level when Indians go to the polls for general elections due by 2004. But some analysts worry that BJP campaign tactics may tilt the party too far to the right. To win voters in Gujarat, BJP Chief Minister Narendra Modi—a Hindu nationalist—is running a religious, pro-Hindu campaign, while his chief opponents in the Congress Party

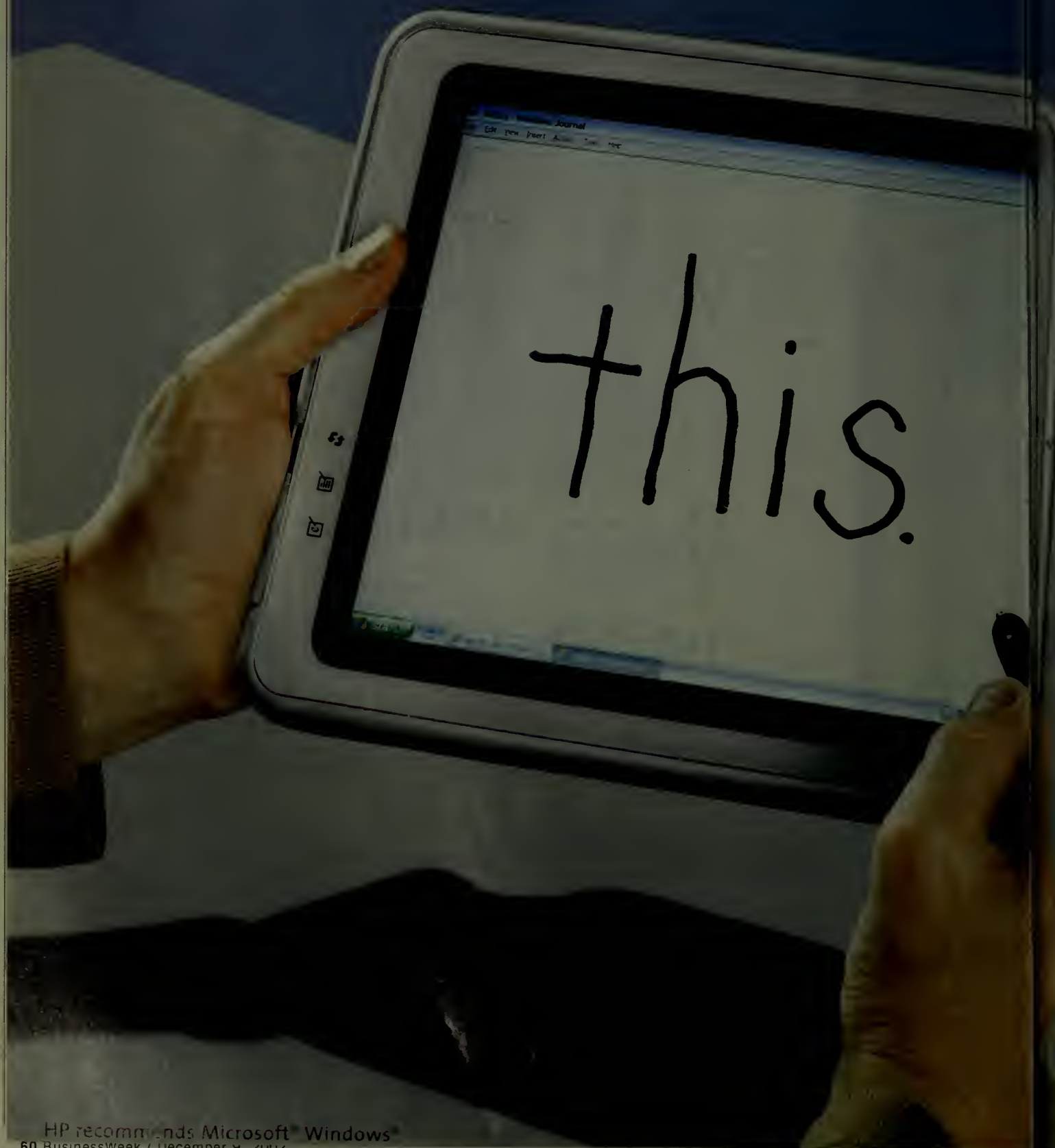
are stressing secularism. A BJP win in Gujarat could boost fundamentalists in the party and lead to further Hindu-Muslim tensions in India, analysts say. That could slow reform and discourage investment.

Indeed, businesspeople in Gujarat are dismayed at how much this year's violence has damaged the economy. Investment in Gujarat will be down some 10% this year, according to the Confederation of Indian Industry, while other Indian states will see investment surge an estimated 7%.

By Manjeet Kripalani in Bombay

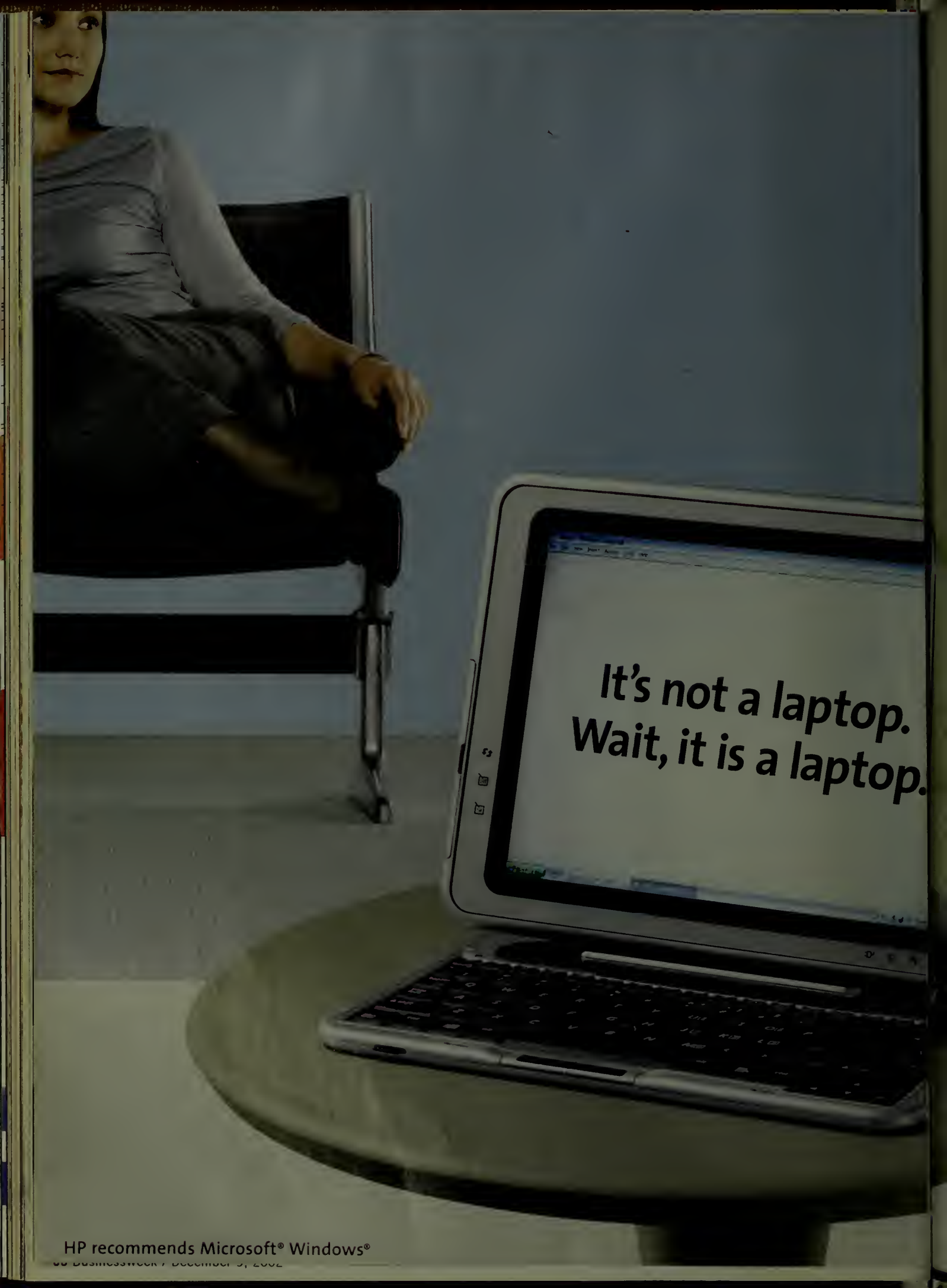
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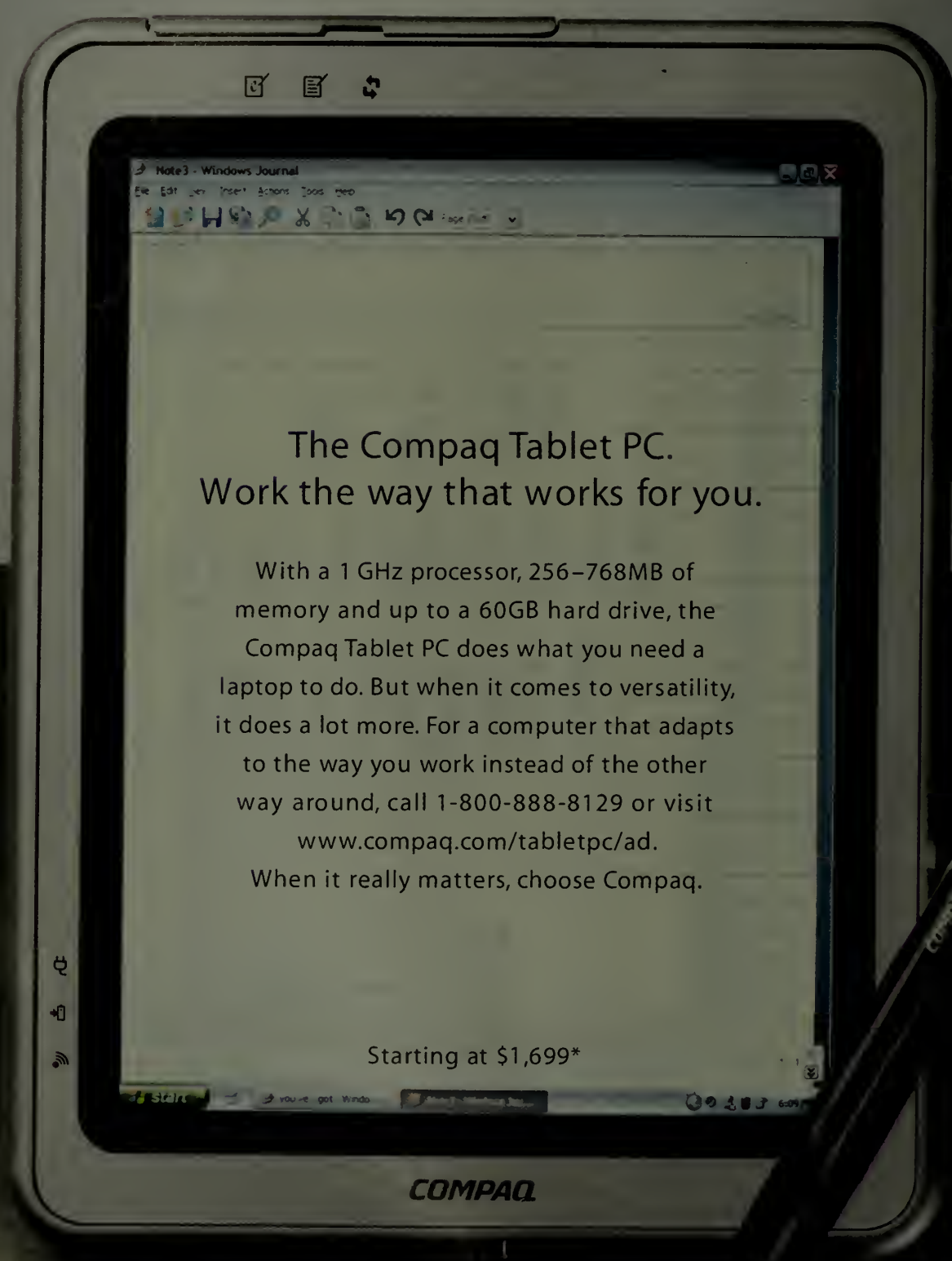
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PHARMACEUTICALS

AN ACHE AT AMGEN?

CEO KEVIN SHARER

boost earnings, analysts say.

Across the country, in North Chicago, Ill., is Abbott, which is counting on Humira to be \$1 billion dollar drug. Abbott filed for Food & Drug Administration approval in April and is hoping to get the nod in the first quarter of 2003. Both Abbott and Amgen face formidable competition, meanwhile, from a top-selling Johnson & Johnson drug, as well as other rivals with rheumatoid arthritis treatments in the pipeline. All are competing for the same prize: a dominant share of an annual market for rheumatoid arthritis medications estimated to hit \$5 billion in 2006.

Amgen drew the unfamiliar role of underdog in this fight. Soon after Enbrel's 1998 launch by its developer, Seattle-

based Immunex Corp., the drug became the gold standard for rheumatoid arthritis treatments. Two injections per week block an inflammation-causing protein called tumor necrosis factor (TNF) that plays a key role in the disease, relieving pain with few side effects. Immunex and now Amgen have had trouble maintaining volume production of the drug, which is grown in finicky cell cultures under exacting conditions. Thus, shortages have left most of the one million patients who might benefit from Enbrel empty-handed. "It has been a huge problem," says Dr. Ernest Brahn, a rheumatology professor at the University of California at Los Angeles. "Some patients are hoarding doses. Others are migrating to different drugs."

Amgen CEO Kevin W. Sharer remains

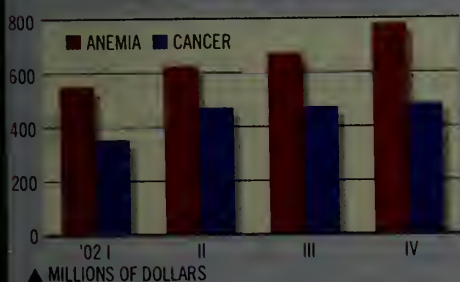
It can't make enough of its hit drug. And rivals are pouring in

For nearly three decades, Richard Shirley's rheumatoid arthritis caused him so much pain that he could barely make it down a flight of stairs. Last year, he considered joining the waiting list for Enbrel, a highly effective Amgen drug that has been in short supply ever since it hit the market in 1998. Instead, Shirley entered a Boston trial for a new Abbott Laborato-

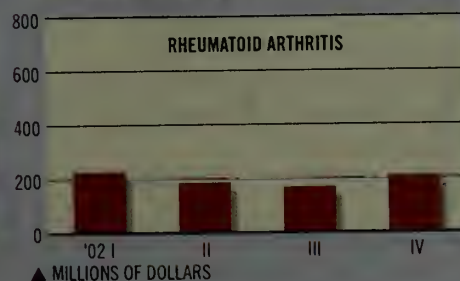
ries drug, Humira. The 62-year-old retired engineer can now walk two miles a day. He dances with his wife and goes bird-watching, virtually without pain. "I'm a nicer guy today because 90% of the pain is gone," he says.

Shirley's story and dozens like it are setting the stage for a messy biotech free-for-all. In one corner is Amgen Inc. of Thousand Oaks, Calif., which spent \$11 billion in December, 2001, to acquire the small company that developed Enbrel. But a chronic shortage of manufacturing capacity, which won't be corrected until January at the earliest, has forced some 30,000 patients onto a waiting list. Enbrel sales have been capped at about \$200 million per quarter as a result—half the amount that Amgen needs for the acquisition to

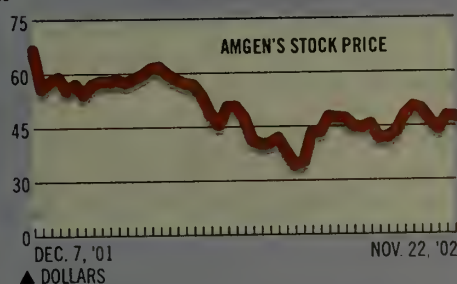
AMGEN'S CORE DRUGS ARE GROWING NICELY...



...BUT SALES OF ENBREL FOR RHEUMATOID ARTHRITIS ARE SLOW...



...TO THE DISMAY OF INVESTORS



Data: Company reports, Sun Trust Robinson Humphrey, Bloomberg Financial Markets

Science & Technology

sanguine: "We haven't missed our window of opportunity," he insists. Still, Enbrel has dragged down an otherwise stellar year. Even though two other new drugs have boosted sales in Amgen's core cancer and anemia markets more than 20% this year, Amgen's gross profit margin dropped from 88% prior to the Immunex acquisition to 85% in the most recent quarter. Amgen must share some of the Enbrel proceeds with marketing partner Wyeth, so it has to sell more of the drug to make a decent profit than it does other products. Some analysts fear Amgen won't return to historic profit levels unless it builds Enbrel into a \$3 billion-a-year drug. "Amgen might have been better off without Enbrel," says Dr. Martin D. Auster, an analyst at SunTrust Robinson Humphrey. Its stock has dropped 25%, to 45, in the past year. The shares "would have been up this year without Enbrel," Auster says. "Everyone is asking: 'Hey, did they really need to do this acquisition?'"

There are no complaints from J&J, which markets a similar drug, Remicade. With \$300 million in sales in the third quarter, Remicade knocked Enbrel out of the top spot, even though patients have to take the J&J medication with methotrexate, which causes nausea.

Abbott is even better positioned to capitalize on Enbrel's misfortunes. Its Humira has a compelling selling point: convenience. Patients need to inject the drug only once every two weeks, vs. twice weekly for Enbrel. And unlike Enbrel, which is derived in part from hamster proteins, Humira is made entirely from human proteins. That means it can circulate in the body longer, with less risk of tripping an immune response. The drug also comes in pre-packaged syringes, making it easier to take. And Abbott has been gearing up for Humira's launch by expanding its manufacturing capacity to ensure that there's a steady supply. Abbott CEO Miles D. White says he will have lots of eager takers among patients who haven't been able to get their hands on Enbrel. "We'll have plenty of room to play here. And this won't be viewed as a me-too drug," he says.

White can't afford to be wrong. His 102-year-old company has turned out only one billion-dollar drug in the past 12 years, the antibiotic Biaxin, and its sales are slipping. Plus, Abbott is still reeling from manufacturing quality problems that resulted in \$195 million in FDA fines

in the last three years—on top of a \$437.5 million fine Abbott paid in 2001 to settle criminal billing-fraud charges brought by the Justice Dept. Analysts expect the company's earnings to grow just 10% this year, far below the industry average of 17%, and Humira is the only drug with blockbuster potential in Abbott's near-term pipeline.

Amgen isn't taking the Abbott onslaught lightly. Dr. Roger M. Perlmutter, executive vice-president for research and

BATTLE LINES

Competition is brewing among three giants in the \$5 billion market for rheumatoid arthritis drugs



ABBOTT LABORATORIES

Drug: Humira

Selling point: Other drugs are derived in part from rodent cells, but this one is fully human. It can be injected once every two weeks.

AMGEN

Drug: Enbrel

Selling point: Twice-weekly injections can control patients' pain and joint damage with minimal side effects.

JOHNSON & JOHNSON

Drug: Remicade

Selling point: It is administered to patients by IV only once every eight weeks. But it must be taken with a companion drug that causes nausea.

development, says Amgen will counter Abbott's attack by emphasizing Enbrel's five-year track record of safety and effectiveness. Some patients in Humira early trials developed tuberculosis, apparently because the drug can allow latent TB to become active. That raises the risk that the FDA may require Abbott to slap a warning on the drug's label, Perlmutter says. (Abbott claims all such drugs carry this risk.) Amgen also plans to test Enbrel at less frequent dosages, so the drug might one day be able to match Abbott's drug on convenience. However, though, Amgen has put such search plans on hold. "Unfortunately, we don't have enough drug to do those studies," Perlmutter admits.

Abbott and J&J aren't the only rivals Amgen faces. Pharmacia and Genentech are also developing rheumatoid arthritis

drugs. That's no surprise, as the total U.S. demand for drugs such as Enbrel and Humira could reach \$7 billion by 2006, analysts say. Some of that will include treatments for other inflammatory diseases, such as psoriasis.

Still, rheumatoid arthritis will account for more than 10% of the market, and Amgen will have to dominate this niche to reach sales of \$3 billion a year. That's the amount CEO Sharer has admitted Enbrel needs to reach for the acquisition to have been worthwhile, but he never predicted when that would happen.

It's enough to make some investors question Immunex' \$11 billion price tag. "That acquisition is starting to look a little expensive," says Sven H. Borho, partner at mutual-fund company ObiMed Advisors LLC, which owns shares of Amgen.

Sharer is eager to prove the critics wrong about the acquisition. The FDA is expected to complete its four-month review of a new Rhode Island plant for Enbrel in December. If the plant wins green light, it could start churning out the drug by January. That won't give Amgen as big a head start on Abbott as it hoped for, but executives remain optimistic. "Here's this wonderful drug that has been completely hamstrung by manufacturing problems," Perlmutter says. "Our goal now is simply to make Enbrel available." That would at least give Amgen a fighting chance in the battle to aid suffering rheumatoid arthritis patients.

By Arlene Weintraub in Los Angeles and Michael Arndt in Chicago

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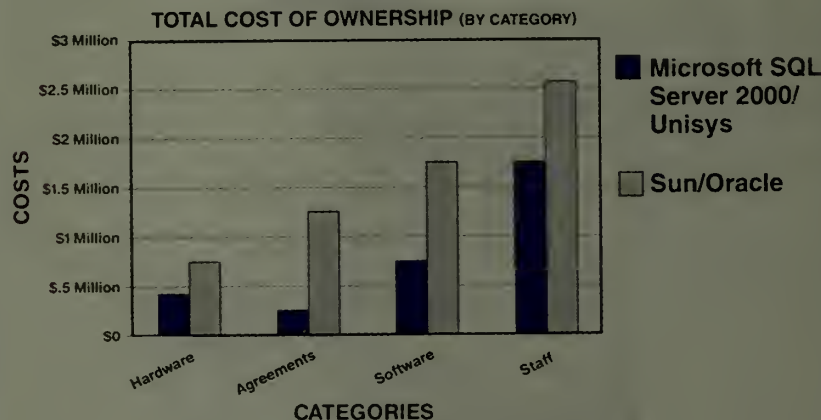
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Figure 6

The Microsoft® SQL Server™ 2000/Unisys BI solution offers \$3.2 million in savings compared with the Oracle/Sun system over a five-year period.



We discovered that the current state of Windows and Intel solutions offers considerable savings and an attractive alternative to the classic RISC/UNIX solutions for BI implementation.

Source: Walklett Group, February 2002

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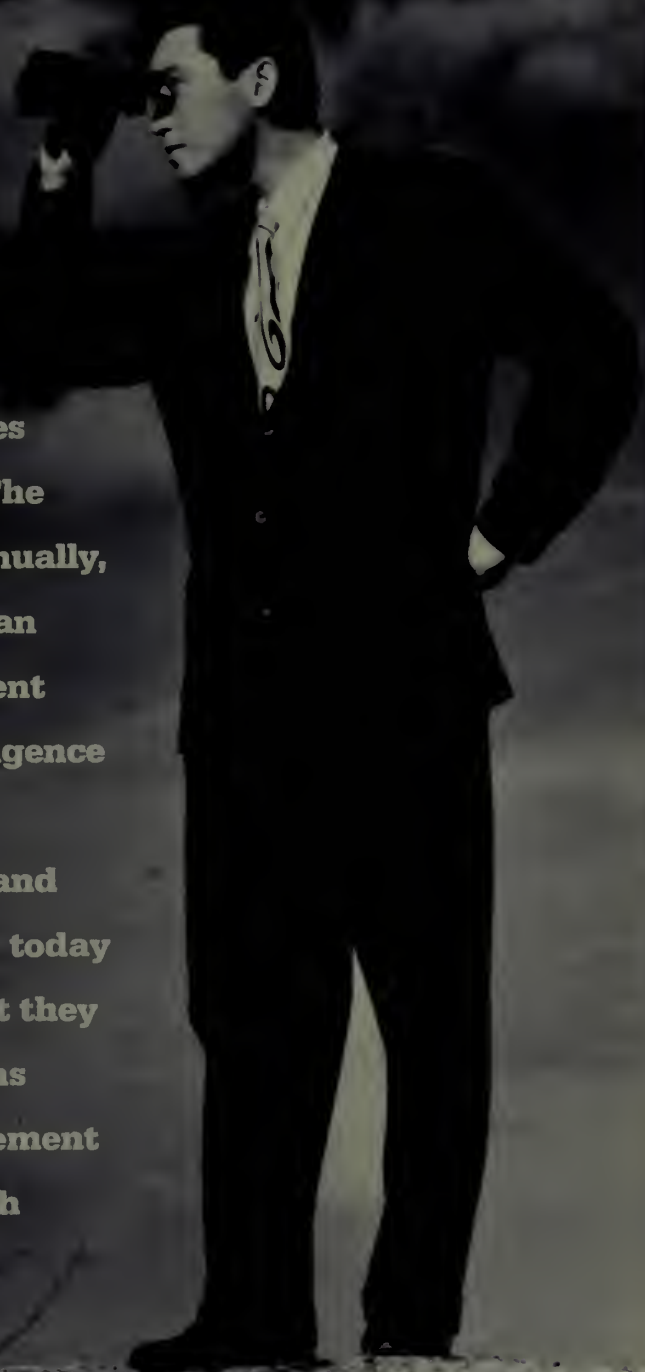
BUSINESS INTELLIGENCE

BETTER INFORMATION = BETTER DECISIONS

Today's business executives are looking for the right answers within the mountains of data.

One of the most underutilized — and potentially valuable — resources any company has is its own data. The amount of data corporations store doubles annually, according to Thomas Weisel Partners LLC, a San Francisco-based merchant bank and investment analyst, building ever larger the store of intelligence that can guide business decisions.

In the face of pressure from the economy and from unsettled stockholders, more companies today are moving to ensure that they are using what they already know. For decades, large organizations have purchased financial and process management suites, each powerful in its own right, but each also a vertical data silo.

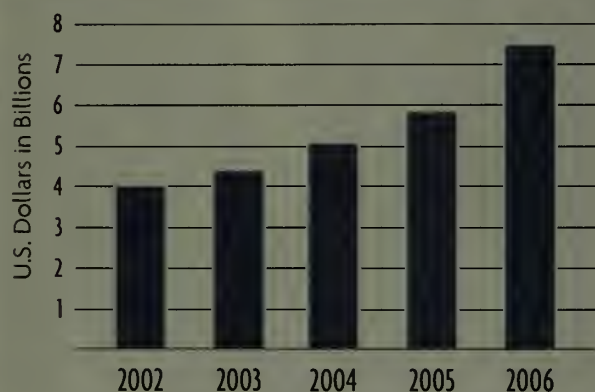


Today's business intelligence (BI) efforts involve drawing and aggregating data from those heterogeneous business systems and providing tools to analyze that data in myriad customized ways. The result? That data is converted into information about the business to support its reporting and decision-making responsibilities.

"Business intelligence is rapidly becoming one of the most critical investments companies are making today," says Bill Baker, general manager for SQL Server Business Intelligence at Microsoft Corp., in Redmond, Wash.

The numbers appear to bear him out. Framingham, Mass.-based market analyst firm International Data Corp. (IDC) projects that BI product sales will

Steady Growth for BI



Source: International Data Corp., July 2002

continue to grow even as software market expenditures are down and IT budgets remain tight. According to company forecasts, the BI market will grow from \$4 billion in 2002 to \$7.5 billion in 2006.

Open Access

There are, to be sure, still some companies that retain rigid hierarchies and fixed decision-making processes. But businesses have spread globally, new sales channels have intensified competitive pressures and technology has reduced decision-making windows. In response, more companies have reengineered their cultures and processes to democratize — or at least decentralize — decision-making, while beefing up the tools senior management has available to monitor the business in real- or near-real-time.

Makers of analytic tools are scrambling to open up access, as well. Keith Gile, a senior industry analyst at Giga Information Group, a Cambridge, Mass., technology advisory company, refers in a recent report to a "BI ghetto" — the failure to involve more than the five percent of the enterprise who are "power users" in making data into intelligent and actionable information.

Another analyst, Mark Smith, president of Full Circle Strategies in Redwood Shores, Calif., notes that it's likely the result of the tools' designs. "Most products

are not designed for user needs," he says. "Rather, they're designed along functional paths such as query and reporting."

Forward-thinking companies have begun to tear down those ghetto walls. Information Resources Inc. is a Chicago-based provider of sales and marketing research in the global consumer goods industry. The firm collects data from a vast array of retailers (among them more than 30,000 grocery stores), creates some of the world's largest data warehouses and sells access to that data to leading consumer goods companies and retailers. CIO Marshall Gibbs says that he is seeing a trend toward democratization — toward "getting BI to the masses."

"In the past, analytic data was only compiled for the executives of a company who would then distribute the information accordingly to various departments — often taking weeks before the data was fully distributed," says Microsoft's Baker. "Today, many more decisions are made in the trenches. Today's employees make tens, hundreds and even thousands more decisions every day that affect the company's success."

In Giga's view, two categories of potential users have been largely overlooked in departmental or work-group BI approaches. One is the business-user community, which makes up a substantial minority of the enterprise's employees. This large group depends on power users within the company to help define the analytic process, but also needs to modify and refine the results — typically through spreadsheet manipulation — to get more detailed analyses. The other category is the huge constituency of extended enterprise users. These are the people who need the analytic data as a basis for decision-making, but must get it from someone else, rather than from the tools directly.

Companies must broaden the deployment of these BI tools as a way to make the enterprise more intelligent and to encourage participation in the decision-making process, says Giga's report. Vendors, in turn, need to shift their development efforts toward tools and functionality that can be understood and exploited by the enterprise audience that makes up the 95 percent of the available workforce, rather than the small percentage of power users.

"In the mainframe world, a large company like Allstate Insurance would have maybe a couple of hundred users of what would now be considered a business intelligence application," says Gerald Cohen, CEO of New York-based Information Builders Inc. (IBI). During the client/server era of the 1980s, that increased by roughly an order of magnitude, to perhaps 5,000 users, because of distributed computing. "Today, thanks to our Web product, that organization will have 50,000 users, almost everybody in an organization," he says.

A Common Methodology

For analytic tools to benefit the majority of corporate users, those who are neither business analysts nor IT specialists, the user interface — the so-called "front

(continued on page 11)



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CASE STUDY

Kids Headquarters Grows Into Its Clothing Business

Kids Headquarters is the largest importer of children's apparel in North America. With its global footprint, the company receives reports from offices in Bangkok, Hong Kong and Manila. And all this production and sales data needs to find its way quickly — and in the right form — to its large, prestigious customers, to its strategic planners and to the desk of the company's CEO.

In a nutshell, the company was not able to get and use what Kevin Downs, Kids Headquarters' chief technology officer, calls "the one true look" into its business information.

And that failure was coming at a cost. Turning its disparate data flows into useful business intelligence (BI) involved as many as 40 people outputting data from Kids Headquarters' back-end business systems and then manually massaging the data to get it into the right form. It was, says Downs, a huge waste of corporate resources.

"The whole feeling was, we need to get information to our users who need it in a more timely fashion, with no need for manual manipulation of the data," he says.

A Custom Approach

Faced with such a challenge, some companies will seek a custom approach. Downs, on the other hand, took the opposite tack, stipulating that the tool Kids Headquarters chose had to be deployable out of the box, with no custom coding required.

Downs says when it came to cost-justifying the BI deployment project, he concluded he couldn't offer a hard, quantified ROI justification. "We knew the solution was economically viable," he reports, and company management was satisfied with his representation that it would free up some 15 percent of the typical company salesperson's time.

Kids Headquarters chose Cognos Series 7 from Cognos Inc., a software vendor based in Burlington, Mass. Deployment, Downs says, was quite rapid: "We spent a lot more time doing data cleaning. Once our data stores were built, we had reports in two days' time."



Interestingly, Downs chose not to involve his salespeople in the deployment process itself, leaving that to the IT department. They were, however, heavily involved in deployment testing, providing user acceptance feedback.

IT, in turn, has had to understand business needs in a new and different way. "I think IT is much more savvy about business needs," observes Don Campbell, vice president of Product Innovation and Technology at Cognos.

Campbell goes on to speak of a "pendulum swing," a shift from individual business-user groups each choosing its own BI package to IT taking leadership in the deployment of one package to serve various needs within the company.

Quick Change

Indeed, the Cognos system has changed many aspects of Kids Headquarters' operation. The clothing importer's CTO uses terms such as "improved agility," and speaks of the company's new-found ability to react quickly to changing market conditions. "With Cognos," Downs says, "we now have mission-critical data on product development, factory

performance, inventory and sales at our fingertips. We are able to drill down to the detail level to really understand the key drivers behind operations and, as a result, improve product planning."

Plus, Kids Headquarters' CEO now receives regular reports in the format he's accustomed to reading, but without the need for multiple staffers to devote time to developing the necessary data. With the Cognos 7 deployment, Downs now has a CEO who's bought into the company's strategic reliance on BI. "He is the first one to embrace a tool when he understands that it can help him."

The ready availability of customized reports has changed how people work. It has generated a new sense of excitement, Downs reports. "When you finally deliver an end product that makes life easier, that's when the excitement starts to build. It's fundamentally changing not only how we do business, but changing the corporate culture associated with it." ■

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STRATEGIC ADVICE

The Half-Dozen Needs of a Good BI Implementation

With fiscal and operational pressures galore, it's sometimes challenging to keep a BI project on-target.

Business intelligence can help a company improve its competitive positioning. BI makes firms better able to understand and control their corporate information. It also can help provide the insight and knowledge necessary to guide the business effectively. The result is reduced costs and increased productivity.

BI-enabling a company, though — getting it to the point where data has been identified, made accessible to key enterprise decision-makers and can be analyzed as needed — will not be easy. It requires an enterprise vision and planning.

But it's worth it. "Seamless access to a range of management tools, using fully integrated enterprise performance data, provides managers the information they need to make coordinated decisions," says Ralph Welborn, managing director of BearingPoint Inc., the McLean, Va., business consulting and systems integration firm formerly known as KPMG Consulting Inc. "This seamless access creates valuable efficiencies that can enhance shareholder value."

Proving ROI

One of the bigger roadblocks for successful BI efforts has been the C-level demand for proving ROI. In many respects, that is an impossible task. Kevin Downs is the chief technology officer of Kids Headquarters, the largest importer of children's apparel in North America. Having overseen a massive BI program at the company, Downs has learned that BI ROI cannot be proven easily and quickly beforehand. (See "Kids Headquarters Grows Into Its Clothing Business," page 5.)

Still, Downs' advice to other companies contemplating a BI deployment is simple: Do it. And, he urges, don't get hung up on demands for a quantified ROI justification. "ROI is a moving target," Downs says. "Push forward the company by convincing senior manage-

ment and the board to embrace an idea that's different, that's out of the box."

Democratizing Data

If, as Marshall Gibbs, CIO of Information Resources Inc., says, effective BI utilization involves a corporate democratization process that will get specific analyses to people who can act on them profitably, then a reengineering of both enterprise data flow and the corporate culture will have to be part of the BI deployment plan. Keith Gile, a senior business analyst at Giga Information Group, notes that the power user has been the primary focus of departmentally targeted BI approaches. For BI to be successfully implemented at the enterprise level,

he says, the needs of a broader array of user constituencies must be addressed.

Bill Baker, general manager for SQL Server Business Intelligence at Microsoft Corp., cites the example of New Zealand-based ASB Bank, which gives its "Personal Bankers" access to business intelligence technology that allows them to sift through a mountain of customer data to match customers with the appropriate products and services. As a result, customers get improved service and more functionality and, the bank profits.

Personalizing Intelligence

Dan Berkey, director of Business Technology Delivery at America West Airlines in Tempe, Ariz., reports that when his company deployed the CleverPath portal from Computer Associates International Inc. (CA) in Islandia, N.Y., its intent was to give employees at its Strategic Operations Center a personalized experience while delivering BI functionality through the medium of a portal.

America West has delivered on that plan. Where once users had to scan white boards, now they are able to log in to a secure portal packaged specifi-

(continued on page 9)





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**Information
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(continued from page 7)

cally for them. Once there, they're offered a snapshot of everything going on that they need to know to do their jobs — namely, tracking the airline's flights.

Empowering Collaboration

"Sharing best practices is one of the primary goals of business intelligence," says Microsoft's Baker, "especially when you roll out BI capabilities to large parts of the organization. Collaboration is central to this."

Bob Lokken, CEO of ProClarity Corp., a vendor of analytics based in Boise, Idaho, arrived at the same conclusion via a slightly different path. "Business intelligence is good at the quantitative part of decision-making. But there are qualitative, subjective aspects — dialog, communicating. For large organizations, figuring out who to ask questions of is tough. Thus,



IT departments must integrate analytic tools and useful data into the everyday applications that users across the company actually use.

there's a natural marriage of BI and collaboration."

Bill Wagstaff, senior vice president of Products and Marketing at Alphablox Inc. in Mountain View, Calif., calls analytic tools "enabling technology." He says "people don't just take numbers at face value. There's a need for people to collaborate to understand, because they're driving for a consistent pattern of corporate behavior. At a higher level, getting new products adopted in multiple markets is not that cut-and-dried. You need human beings in the process."

Many enterprises that have planned wall-to-wall BI deployments have collaboration tools penciled in to later phases of their projects. At Boston Bank of Commerce, CIO Jim Barry reports that as the bank's deployment of CA's CleverPath tools proceeds, collaboration is just a short step away.

Ensuring Security

To deliver on the goal of making BI an everyday thing, IT departments must integrate analytic tools and useful data into the everyday applications that users across the company actually use.

As IT sets about doing that, the need for bullet-proof security protections inevitably will have to be dealt with for the valuable intelligence being shared.

It's an issue of which BI vendors are very much aware. "One of the larger challenges with enterprise information is doing it in very secure environments," says Pete Cittadini, CEO of BI vendor Actuate Corp. in South San Francisco, Calif. "Financial services is a very large sector for us. We believe we'll have appropriate

security algorithms and schemes in place to make collaboration a reality in the true sense of the word."

Web Services

Much has been made of late of the potential for enterprise tools to run as Web-server-based applications that can be accessed via the Internet. Jim Metcalf, director of Foundation Technology Strategy at SAS Institute Inc., acknowledges that this technology is still developing. But, he says, "Web services, in our mind, is a way to integrate" individual tools. It's also a low-overhead approach to standardization. Metcalf acknowledges that there's been much hype in the marketplace, but says that as actual experiences deploying Web services accrue, things will settle down.

"We believe [Web services] will become one of the key integration technologies," Actuate's Cittadini says.

The company is engineering its tools to deliver full functionality via the Web.

Giga's Gile confirms that many BI vendors are beginning to talk about Web services. They are, however, in a difficult position, because it's not up to these application vendors to define the standards for Web services. "I applaud the BI vendors for having something, but making clear it's not a finished product," he says.

IT's Role

If a BI plan is to encompass data and business systems wall-to-wall, IT must drive the strategy and administer the system. Today's business pressures are stimulating a lot of IT-oriented creativity, as managers try and squeeze whatever dollars they can out of existing data warehouses. "Our customers are always looking for more ways to put their information to work for them, whether it is to drive additional revenue, be more competitive or improve customer service," says Roy Sanford, vice president of Enterprise Alliances at EMC Corp. in Hopkinton, Mass.

"Business intelligence has largely been departmental technology," says Dave Kellogg, senior vice president of Marketing at Business Objects SA in San Jose. "CIOs now are waking up to the fact that they have gremlins, in the form of all sorts of little BI systems, deployed."

"I think what's going on now," says Bob Moran, research vice president and managing director, Data Knowledge & Analytics, at the Aberdeen Group Inc. in Boston, "is a recognition once again that you need strong technology." ■

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(continued from page 3)

end" of the tool — must be both easy to use and customizable to suit individuals' languages, cultures, work styles and job-related needs. For example, New York-based DDB Worldwide, the second-largest worldwide advertising agency, has 206 offices in 99 countries. Working with SAS Institute Inc. of Cary, N.C., DDB put in place a Web-style interface to SAS's data analysis tools. DDB employees anywhere in the world can use this interface to access data, customize it to suit their needs and then use the data to develop presentations and reports on demand.

One unanticipated positive result of deploying this system, observes Ned Anschuetz, DDB's Chicago-based senior vice president of Planning, "is the way in which this brings together people in far-flung offices. They now have a common methodology for approaching strategic planning problems on behalf of their clients." He calls the system "a great unifier."

Jim Metcalf, director of Foundation Technology Strategy at SAS, notes that the company's Internet product allows DDB to deliver the entire SAS platform over the Web, thereby making it possible for users to run reports in less than one minute. And, he adds, the system supports collaboration among dispersed DDB team members. "Being able to share the answer to a question with the group that matters," says Metcalf, "is very important."

It's important because analytics often are only an enabling technology. People can — and probably should — choose not to take numbers or analyses at face value. There's a need for people to collaborate to understand, for a group process of discussion to occur, to convert intelligence into knowledge.

Not so long ago, the technology to support knowledge-oriented collaboration wasn't available. Now, it is rapidly becoming a necessity. Notes IBI's Cohen: "Information is now being distributed to people outside of an organization, such as customers, to achieve a competitive advantage."

Defining Value

Visions of collaborative decision-making based on integrated enterprisewide data are compelling, but pretty pictures don't sell well in the boardroom these days.

In some cases, numbers aren't needed. Microsoft's Baker says he has seen numerous cases where BI made all the difference in a company's ability to compete at all. He offers the telco industry as an example: "Take a cell phone service provider who sees its business rapidly drop toward zero when competitors reprice and repackage their offerings. That customer then reprices and repackages its offering within hours. BI enabled this company to do this profitably. Prior attempts were hit-or-miss. For this company, the ROI of the BI solution is essentially infinite."

BI RESOURCES

BearingPoint Inc.

www.bearingpoint.com

Business Objects SA

www.businessobjects.com

EMC Corp.

www.emc.com

Information Builders

www.informationbuilders.com

Microsoft Corp.

www.microsoft.com

SAS Institute Inc.

www.sas.com

For others, there are order-of-magnitude approximations. DDB's Anschuetz lays it out this way: The approximately 800 requests for customized analyses run against DDB's data received in two months from outside the United States previously would have cost \$500 each from a research supplier. That's \$400,000 saved, or delivered as added value, to DDB's clients. Bottom line? "It's definitely contributed directly to millions of dollars of revenue," he says.

Giga's Gile argues that to deliver maximum value, BI must be a centrally controlled asset. That means a corporation's IT department must take control of the BI deployment as well as play a major

role in quantifying the value of the package to the company. It can, for example, estimate the reduced cost of application development associated with the use of a single development environment companywide and predict revenue-per-customer increments resulting from application analytic and predictive modeling tools.

Bridging the Gap

The IT infrastructure of business was, once upon a time, based on large mainframes and green-screen terminals. Then came the mini-computer and the client/server model. Today's vision of the seamlessly integrated company — able to react quickly and turn on a dime for competitive advantage — requires the best of both worlds: a seamlessly integrated data universe that can be sliced, diced and manipulated at will from the desktop or, for that matter (security permitting), from the wireless portable, PDA or cell phone.

The key is access to knowledge, and deploying effective BI tools is a critical step toward that goal. When data can be drawn from the many different places in which it resides, it yields information about the business's operations, customers and partners. ■

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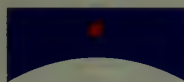
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Business Intelligence Section writer: Alan S. Kay



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BUSINESS OBJECTS®

Developments to Watch

EDITED BY CATHERINE ARNST

MAKING COMPANY AIRWAVES SAFE FOR WIFI

PEOPLE WHO SURF THE NET at home on wireless "WiFi" networks often wish they could roam untethered with the same laptop at work. Usually that's not possible. For one thing, inexpensive, standardized technology that makes these networks so popular in homes, at Starbucks, and in other wireless hot spots includes standard encryption that corporate network managers hate because it is so easy to hack. "Everyone knows how to break it. You can do it in 10 minutes," says Pankaj Manglik, a founder of startup Aruba Wireless Networks.

Manglik and co-founder Keerti Melkote have designed tools to let the corporate IT guys lock down the airwaves. The main component is a secure wireless network switch that sits in the wiring closet next to the other critical network devices. That switch applies control mechanisms to packets of data that travel over the air, allowing legitimate users onto the network, blocking others, and keeping the systems people briefed. Aruba has filed for patents and begun talking with potential customers in financial services and other sectors. *Neil Gross*

BETTER MEMORY THROUGH BIOCHEMISTRY?

THE HORMONE ESTROGEN HAS taken considerable heat for its probable role in breast-cancer development, but it brings advantages, too. Motherhood, it seems, protects the brain by washing it with estrogen and other hormones. Craig H. Kinsley, associate professor of neuroscience at Virginia's University of Richmond, told a recent meeting of the Society of Neuro-

EVEN THE GREENS WILL LIKE THESE GREENS

ENVIRONMENTALISTS HAVE LONG REVEILED GOLF COURSES because of their profligate use of water and dependence on pesticides and herbicides. One solution might be new varieties of a grass called seashore paspalum, which were discovered in South Africa and adapted by researchers at the University of Georgia.

Because the grass has deep roots and is saltwater-tolerant, it can flourish on less than half the water and fertilizer needed for the Bermuda grass favored for golf courses. Paspalum also eliminates the need for most herbicides and pesticides: Small quantities of salt can be used to kill weeds.

The new varieties have already been adopted at 39 courses in the U.S., including the venerable Sea Island Golf Club in Georgia, and a further 50 links in Malaysia, China, the Middle East, and the Caribbean. Jim Torba, superintendent at Bayshore Golf Course in Miami Beach, says he used to spend \$300,000 a year on water for Bermuda and tufted dwarf grasses. Since resodding the course last May with the new variety of paspalum, he has slashed his water bill by 80% and drastically cut back on pesticides. What's more, says University of Georgia turf researcher Ronny Duncan, paspalum's dense, waxy feel has won favorable reviews from some golfers. Duncan says the grass works best in the warmer climates. *Dean Foust*



science that female rats that have had two or more litters of pups do much better in tests of memory than rats with no young. Mother rats' brains also undergo structural changes that may protect them against Alzheimer's. Estrogen, which increases in the brain during pregnancy, may strengthen neurons, says Kinsley.

Other substances appear to be brain boosters: A team of Tufts University researchers told the meeting that rats fed on blueberry supplements equal to one cup daily in hu-

mans for two months showed improved memory performance. Blueberries are very high in antioxidants, which shield cells from the rogue molecules that speed the aging process. ■



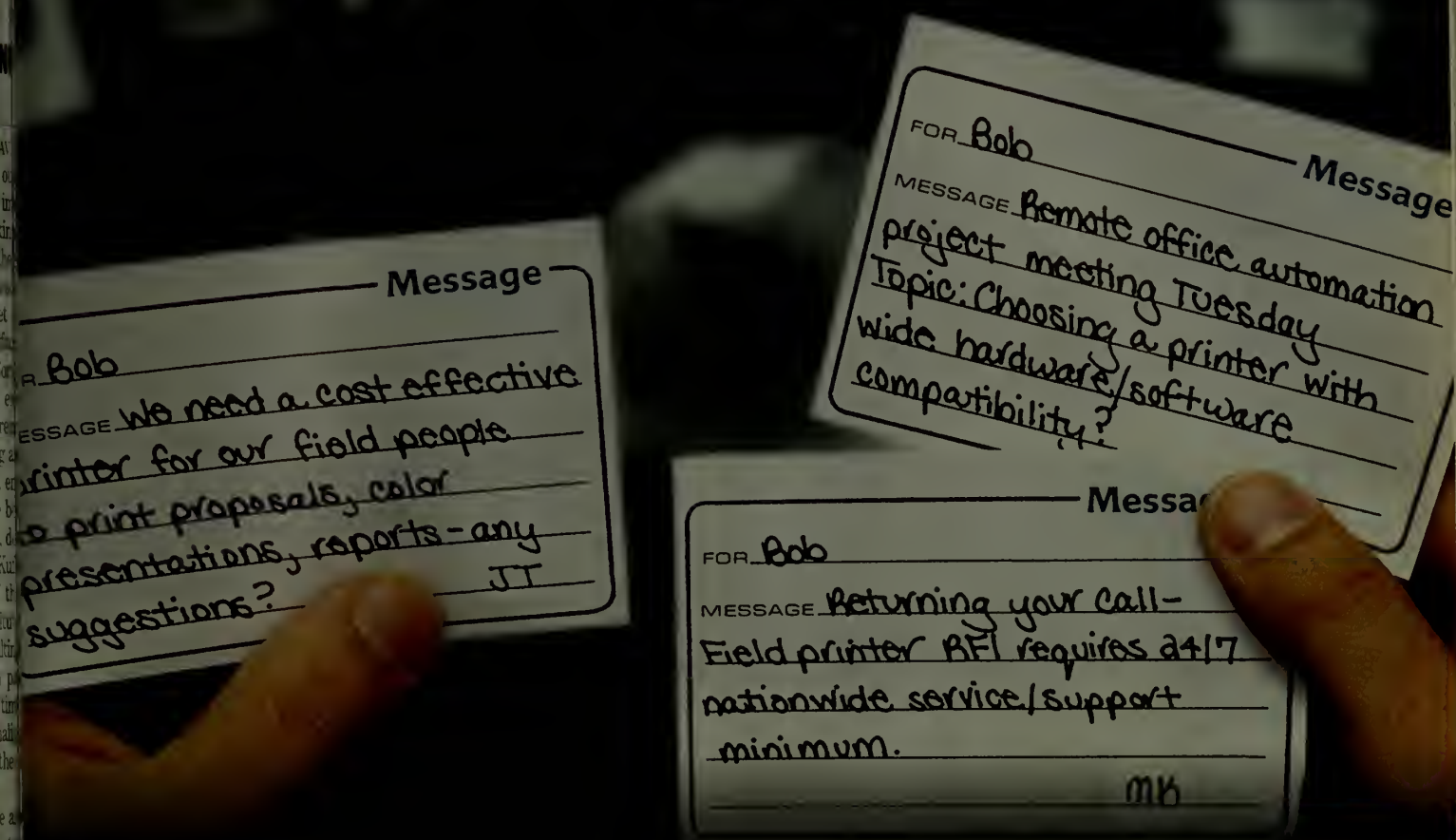
SIDE BENEFIT? Motherhood may guard women's brains

A CANCER VACCINE TO MAKE THE IMMUNE SYSTEM SMARTER

CANCER RESEARCHERS HAVE long been trying to figure out a way to goad the body's immune system into attacking tumors. Toward that end, they have developed dozens of vaccines that typically target a specific protein on the surface of cancer cells. Genzyme Corp. in Framingham, Mass., is exploring a radically different approach: electrically fusing an immune-system cell to an entire cancer cell. The hope behind the fusion technique, developed by Dr. Donald Kufe and Dr. Jianlin Gong of the Dana-Farber Cancer Institute in Boston, is that the resulting vaccine, tailored to each patient, will have an easier time finding and destroying malignant cells that might otherwise evade detection.

In November, Genzyme announced that it had started enrolling 30 kidney-cancer patients in its first clinical trial of the vaccine, conducted at Beth Israel Deaconess Medical Center in Boston. Patients will have some cancer cells surgically removed and fused to dendritic cells, which have the power to initiate a full-blown immune-system response. The resulting molecules will be administered to the patient through multiple injections in the thigh and abdomen. Once infused, the molecules should be able to trigger a response that will target whole cancer cells with greater efficacy than other experimental vaccines.

Dr. David Avigan of Beth Israel, the lead investigator, says kidney cancer, one of the deadliest forms of the disease, is particularly hard to treat because it quickly spreads through the body. "Our hope," he explains, "is to demonstrate the potential of innovative vaccines for the treatment of cancer, without harmful side effects."



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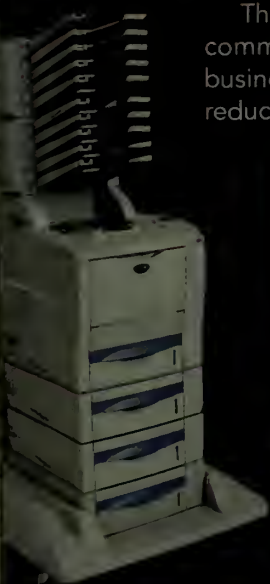
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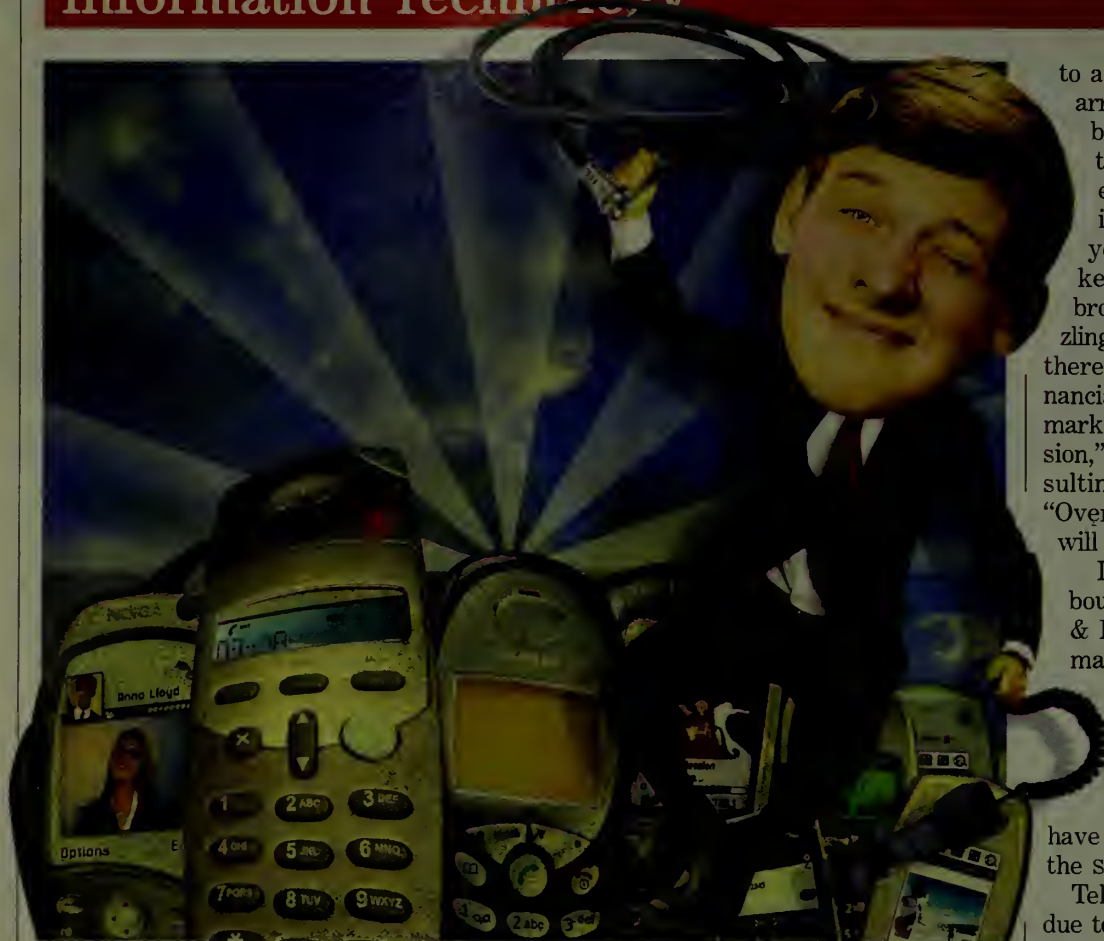
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TELECOM

LIGHT AT THE END OF THE FIBER?

Finally, the telecom depression is starting to lift

On the surface, telecom still looks like a mess. News about the industry is dominated by WorldCom Inc.'s bankruptcy and the scandal surrounding Citigroup's fallen telecom guru, Jack Grubman. Local phone giant SBC Communications Inc. is in the midst of laying off 11,000 people, while its ex-

ecutives warn that new rules forcing it to sell local phone service to rivals could bankrupt the company. All the while, telecom players are groaning under too much debt and too much capacity.

Dig deeper, though, and you'll see signs that the two-year-old depression is actually beginning to lift. Trends point

to a turnaround that, experts say, could arrive sooner than the 2004 many have been predicting. The new cyclical nature of telecom, which tracks the economy more closely, could lead to increased spending in the coming year. Prices have stopped falling in key markets. Potentially lucrative broadband is catching on just as dazzling new phones hit store shelves. And there has been a smattering of good financial news. "The fourth quarter could mark the bottom of the telecom depression," says Tom Lauria, founder of consulting firm Avtera Management LLC. "Over the next six to nine months, we will see early signs of a recovery."

Investors may already think the rebound is starting. While the Standard & Poor's telecom index lags the broader market for the year, it has rallied in late. The telecom group is down 32% since Jan. 1, compared with a 20% decline for the S&P 500 stock index. But measured over the past four weeks, telecom stocks have gained 11%, compared with 3% for the S&P 500.

Telecom's improving outlook is largely due to its closer ties to the economy. For decades, telecom services were mostly voice calls. Demand grew mostly with the size of the population. Now, telecom is a more complex critter with all sorts of new services—everything from speed Web access into homes to robust data networks for corporations. Since 1990, data has accounted for well over half of all telecom traffic. So as the economy improves, consumers and companies are apt to spend more on discretionary services.

Moreover, the underlying growth in demand for telecom is much stronger than most people thought. In November the Commerce Dept. issued a report on the value added to the U.S. economy by various industries—that is, their total output of goods and services minus the value of the inputs they used. The report showed that the value added by the telecom-service sector rose 12% last year. While that was below the 14% growth of 1999 and 2000—before the recession hit—

SIGNS OF A TELECOM RECOVERY

The industry is wracked by bankruptcy and scandal, but new trends point toward recovery. Here's why:

MORE CYCLICAL

Telecom once depended on voice service, a staple in good times and bad. Services like Net access now account for most telecom traffic. As the economy improves, spending will rise.

IMPROVING PROFITS

They're uneven, but profits are picking up, especially in wireless. Nextel Communications just posted its second quarterly profit. And giant Vodafone beat industry expectations.

STABILIZING PRICES

While pricing power is still weak, carriers say prices are stabilizing. And on some international routes, like New York to London, prices have increased during the past few months.

NEW PRODUCTS

The adoption of new offerings, including broadband service, is rising. And a new generation of wireless phones with color screens and cameras could spark demand.

BUSINESS TRIVIA QUESTION

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it was much faster than the 6% growth that the industry averaged earlier in the 1990s. The upshot? Once telecom works out its pricing and debt problems, it should benefit from strong demand.

In fact, some prices are stabilizing or even rising. Weaker carriers have gone bankrupt, easing some of the pricing pressure that squeezed the industry. In most markets, prices fell 2% to 4% from April to October, according to market researcher TeleGeography Inc.—a much more modest decrease than the 70% annual drops in 2000 and 2001. Prices along the Atlanta-New York route actually rose 4.6%.

Spending on broadband is picking up, too. During the third quarter, Comcast Corp. and AT&T Broadband, which are now one company, added 342,000 new cable-modem subscribers, their best showing ever. Industrywide, the number of residential broadband subscribers grew 66% during the third quarter. As the need for capital spending on broadband slows down, telecom companies will start to profit from the service.

Financial results are improving for a handful of carriers. Vodafone Group, the world's largest telecom player, reported better-than-expected results on Nov. 12. It cut its loss for the first six months of the year to \$7 billion, about half the loss of a year ago. It also forecast stronger than expected subscriber growth of 10% this year. Vodafone shares rose 10%, to \$17, in a single day. On Oct. 24, wireless carrier Nextel Communications Inc. reported its second consecutive quarterly profit—after 10 years of losses. Nokia CEO Jorma Ollila said handset sales will rise 10% to 15% annually over the next few years—better than the single-digit increase analysts had expected. “What it says is that even in a very highly competitive industry, a differentiated product can be successful,” explains analyst Craig Mallitz of Legg Mason Wood Walker Inc.

New services could also boost revenues. After years of broken promises, the wireless industry is rolling out a new generation of handsets with color screens, cameras, and Internet connections that are as fast as a 56K modem. They follow the introduction of higher-speed mobile-Internet services during the spring and summer, which helped spike usage 25% this year, according to Joseph McCabe, chief financial officer at AT&T Wireless Services Inc.

None of this is to suggest that the pain for this industry is ending. But as telecom winds up another dreadful year, it appears that the worst is over.

By Steve Rosenbush, with Peter Coy,
in New York

PHONE GIANTS LET THE FUR FLY

It's an angry advertising campaign that brands local phone giant SBC Communications Inc. as heartless. In newspapers and on TV, the ads, sponsored by an industry group called Voices for Choices, depict SBC as a wolf in sheep's clothing—one that laid off 11,000 workers one day and bragged to Wall Street the next about its huge profits. The ads suggest that SBC cares less about customers and workers than its bottom line. SBC is "pulling the wool over your eyes," the ads say.

Maybe so. But Voices for Choices

kind: In a nearly \$5 million campaign, SBC attacks "mudslingers" who "hide behind a lot of different names."

Why the ad battle royal now? Federal regulators, as well as those in SBC states—Texas, Michigan, Illinois, and California—are weighing rules that will set the prices competitors must pay to access local network lines and switches. The phone companies are hoping that a groundswell of public opinion will pull regulators their way. At stake: SBC's push into long-distance service.

and opportunities for AT&T, WorldCom, and others to offer immediate competition in the local residential markets, long dominated by the Bells.

This is no trifling matter. The brawl is over the nation's 180 million customers. SBC, far more than the other Bells, complains that selling rivals cheap access to its local networks threatens its existence. "Any business that sells below its cost on its core product for long enough doesn't make it," says SBC Chief Executive Edward E. Whitacre Jr. Nonsense, declare AT&T officials. They say that SBC bends figures to make its plight appear dire. "It doesn't take a genius to figure out [SBC's] claims of costs are phony," says James W. Cic-

coni, AT&T's general counsel.

Either way, research has shown that barrages of negative ads often backfire with consumers. And few believe that state or federal regulators pay much attention to the ad war on the airwaves. "Do the ads move the regulators here?" asks Laura A. Chappelle, chair of the Michigan Public Service Commission. "Not in the minutest bit." But until the telecom wars are won, SBC and AT&T won't stop trying.

By Roger O. Crockett in Chicago



They hide behind a lot of different names. But none is more accurate than "Cry Baby."

● 凡在本行開辦的各項業務中，凡有涉及本行信譽、利益、安全等事項，均應及時向本行報告，並採取必要措施，防止事態擴大。

After all, they make big profits on the basis of the good values nation of life. The value we have to look at here is the value of the human mind in the



SBC - the giant Bell monopoly - cries that without government protection, they'll go out of business.

But independent voices say SBC's disguise is wearing thin.

Chicago Tribune Los Angeles Times

...the ... of the ...

isn't what it appears to be, either. Far from its grass-roots sound, the organization is a Washington-based lobbying group funded by AT&T, WorldCom Inc., and other Bell rivals. The organization is pumping more than \$2.5 million into ads that run in SBC's home states, including Michigan and California. "I don't think there has ever been an example of this type of corporate trashing," says SBC President and former Al Gore campaign manager William M. Daley. But his company is responding in



BABY BELL
TALK: *SBC*
claims selling
rivals cheap ac-
cess to its local
networks would
threaten its
very existence



GOING FOR THE JUGULAR: *AT&T* says *SBC* is misstating the cost of doing business to make its situation seem more precarious

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Safety Information: Adverse events possibly, probably or definitely related to use of AndroGel® in the controlled trial (n=154) across all dose levels reported in at least 2% of patients included lab test abnormal 5.8%, acne 5.2%, application site reaction 5.2%, prostate disorder 4.5%, headache 2.6%, and hypertension 2.6%.

• Adverse events possibly, probably or definitely related to use of AndroGel in a 1-year follow up (n=106) across all dose levels reported in at least 2% of patients included application site reaction 9.4%, prostate disorder 8.5%, acne 5.7%, and lab test abnormal 4.7%.

• Androgens are contraindicated in men with carcinoma of the breast, or known or suspected carcinoma of prostate. Geriatric patients treated with androgens may be at an increased risk for the development of prostatic hyperplasia and prostatic carcinoma.

• To minimize the potential transfer of testosterone to another person, patients should wash their hands immediately with soap and water after application of AndroGel. They should cover the application site(s) with clothing after the gel has dried.



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Please see brief summary of prescribing information.

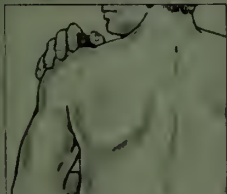
Fatigued?

Depressed mood?

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Could be your testosterone is running on empty.

An estimated 4-5 million American men have a medical condition called hypogonadism, or low testosterone.¹ These low testosterone levels can cause a number of different symptoms such as low sex drive, fatigue, depression, and even loss of height or strength. Your doctor can check your testosterone level with a simple blood test.



Fortunately you can replace testosterone with AndroGel[®] which delivers natural testosterone in a gel that you simply rub into your skin – no patches or injections. As it's absorbed through your skin, AndroGel treats hypogonadism by restoring your testosterone to its normal range.

1. www.fda.gov/fdac/departs/196_upd.html, accessed May 17, 2002

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(testosterone gel) 1% CIII

Testosterone restored



AndroGel® (testosterone gel) 1% CIII

INDICATIONS AND USAGE

AndroGel® is indicated for replacement therapy in males for conditions associated with a deficiency or absence of endogenous testosterone:

1. Primary hypogonadism (congenital or acquired)—testicular failure due to cryptorchidism, bilateral torsion, orchitis, vanishing testis syndrome, orchiectomy, Klinefelter's syndrome, chemotherapy, or toxic damage from alcohol or heavy metals. These men usually have low serum testosterone levels and gonadotropins (FSH, LH) above the normal range.
2. Hypogonadotropic hypogonadism (congenital or acquired)—idiopathic gonadotropin or luteinizing hormone-releasing hormone (LHRH) deficiency or pituitary-hypothalamic injury from tumors, trauma, or radiation. These men have low testosterone serum levels but have gonadotropins in the normal or low range.

AndroGel® has not been clinically evaluated in males under 18 years of age.

CONTRAINDICATIONS

Androgens are contraindicated in men with carcinoma of the breast or known or suspected carcinoma of the prostate.

AndroGel® is not indicated for use in women, has not been evaluated in women, and must not be used in women.

Pregnant women should avoid skin contact with AndroGel® application sites in men. Testosterone may cause fetal harm. In the event that unwashed or unclothed skin to which AndroGel® has been applied does come in direct contact with the skin of a pregnant woman, the general area of contact on the woman should be washed with soap and water as soon as possible. *In vitro* studies show that residual testosterone is removed from the skin surface by washing with soap and water.

AndroGel® should not be used in patients with known hypersensitivity to any of its ingredients, including testosterone USP that is chemically synthesized from soy.

WARNINGS

1. Prolonged use of high doses of orally active 17-alpha-alkyl androgens (e.g., methyltestosterone) has been associated with serious hepatic adverse effects (peliosis hepatis, hepatic neoplasms, cholestatic hepatitis, and jaundice). Peliosis hepatis can be a life-threatening or fatal complication. Long-term therapy with testosterone enanthate, which elevates blood levels for prolonged periods, has produced multiple hepatic adenomas. Testosterone is not known to produce these adverse effects.
2. Geriatric patients treated with androgens may be at an increased risk for the development of prostatic hyperplasia and prostatic carcinoma.
3. Geriatric patients and other patients with clinical or demographic characteristics that are recognized to be associated with an increased risk of prostate cancer should be evaluated for the presence of prostate cancer prior to initiation of testosterone replacement therapy. In men receiving testosterone replacement therapy, surveillance for prostate cancer should be consistent with current practices for eugonadal men (see PRECAUTIONS: Carcinogenesis, Mutagenesis, Impairment of Fertility and Laboratory Tests).
4. Edema with or without congestive heart failure may be a serious complication in patients with preexisting cardiac, renal, or hepatic disease. In addition to discontinuation of the drug, diuretic therapy may be required.
5. Gynecomastia frequently develops and occasionally persists in patients being treated for hypogonadism.
6. The treatment of hypogonadal men with testosterone esters may potentiate sleep apnea in some patients, especially those with risk factors such as obesity or chronic lung diseases.

PRECAUTIONS

Transfer of testosterone to another person can occur when vigorous skin-to-skin contact is made with the application site (see Clinical Studies). The following precautions are recommended to minimize potential transfer of testosterone from AndroGel®-treated skin to another person:

- Patients should wash their hands immediately with soap and water after application of AndroGel®.
- Patients should cover the application site(s) with clothing after the gel has dried (e.g., a shirt).
- In the event that unwashed or unclothed skin to which AndroGel® has been applied does come in direct contact with the skin of another person, the general area of contact on the other person should be washed with soap and water as soon as possible. *In vitro* studies show that residual testosterone is removed from the skin surface by washing with soap and water.

Changes in body hair distribution, significant increase in acne, or other signs of virilization of the female partner should be brought to the attention of a physician.

General

The physician should instruct patients to report any of the following:

- Too frequent or persistent erections of the penis.
- Any nausea, vomiting, changes in skin color, or ankle swelling.
- Breathing disturbances, including those associated with sleep.

Information for Patients

Advise patients to carefully read the information brochure that accompanies each carton of 30 AndroGel® single-use packets.

Advise patients of the following:

- AndroGel® should not be applied to the scrotum.
- AndroGel® should be applied once daily to clean, dry skin.
- After application of AndroGel®, it is currently unknown for how long showering or swimming should be delayed. For optimal absorption of testosterone, it appears reasonable to wait at least 5-6 hours after application prior to showering or swimming. Nevertheless, showering or swimming after just 1 hour should have a minimal effect on the amount of AndroGel® absorbed if done very infrequently.

Laboratory Tests

1. Hemoglobin and hematocrit levels should be checked periodically (to detect polycythemia) in patients on long-term androgen therapy.
2. Liver function, prostatic specific antigen, cholesterol, and high-density lipoprotein should be checked periodically.
3. To ensure proper dosing, serum testosterone concentrations should be measured (see DOSAGE AND ADMINISTRATION).

Drug Interactions

Oxyphenbutazone: Concurrent administration of oxyphenbutazone and androgens may result in elevated serum levels of oxyphenbutazone.

Insulin: In diabetic patients, the metabolic effects of androgens may decrease blood glucose and, therefore, insulin requirements.

Propranolol: In a published pharmacokinetic study of an injectable testosterone product, administration of testosterone cypionate led to an increased clearance of propranolol in the majority of men tested.

Corticosteroids: The concurrent administration of testosterone with ACTH or corticosteroids may enhance edema formation; thus, these drugs should be administered cautiously, particularly in patients with cardiac or hepatic disease.

Drug/Laboratory Test Interactions

Androgens may decrease levels of thyroxine-binding globulin, resulting in decreased total T4 serum levels and increased resin uptake of T3 and T4. Free thyroid hormone levels remain unchanged, however, and there is no clinical evidence of thyroid dysfunction.

Carcinogenesis, Mutagenesis, Impairment of Fertility

Animal Data: Testosterone has been tested by subcutaneous injection and implantation in mice and rats. In mice, the implant induced cervical-uterine tumors, which metastasized in some cases. There is suggestive evidence that injection of testosterone into some strains of female mice increases their susceptibility to hepatoma. Testosterone is also known to increase the number of tumors and decrease the degree of differentiation of chemically induced carcinomas of the liver in rats.

Human Data: There are rare reports of hepatocellular carcinoma in patients receiving long-term oral therapy with androgens in high doses. Withdrawal of the drugs did not lead to regression of the tumors in all cases.

Geriatric patients treated with androgens may be at an increased risk for the development of prostatic hyperplasia and prostatic carcinoma.

Geriatric patients and other patients with clinical or demographic characteristics that are recognized to be associated with an increased risk of prostate cancer should be evaluated for the presence of prostate cancer prior to initiation of testosterone replacement therapy.

In men receiving testosterone replacement therapy, surveillance for prostate cancer should be consistent with current practices for eugonadal men.

Pregnancy Category X (see Contraindications)—Teratogenic Effects: AndroGel® is not indicated for women and must not be used in women.

Nursing Mothers: AndroGel® is not indicated for women and must not be used in women.

Pediatric Use: Safety and efficacy of AndroGel® in pediatric patients have not been established.

ADVERSE REACTIONS

In a controlled clinical study, 154 patients were treated with AndroGel® for up to 6 months. Adverse events possibly, probably or definitely related to the use of AndroGel® and reported by ≥1% of the patients are listed in Table 1.

Table 1. Adverse Events Possibly, Probably or Definitely Related to Use of AndroGel® in the Controlled Clinical Trial

Adverse Event	5 g	7.5 g	10 g
Acne	1%	3%	8%
Alopecia	1%	0%	1%
Application Site Reaction	5%	3%	4%
Asthenia	0%	3%	1%
Depression	1%	0%	1%
Emotional Lability	0%	3%	3%
Gynecomastia	1%	0%	3%
Headache	4%	3%	0%
Hypertension	3%	0%	3%
Lab Test Abnormal*	6%	5%	3%
Libido Decreased	0%	3%	1%
Nervousness	0%	3%	1%
Pain Breast	1%	3%	1%
Prostate Disorder**	3%	3%	5%
Testis Disorder	3%	0%	0%

*Lab test abnormal occurred in nine patients with one or more of the following events: elevated hemoglobin or hematocrit, hyperlipidemia, elevated triglycerides, hypokalemia, decreased HDL, elevated glucose, elevated creatinine, or elevated total bilirubin.

**Prostate disorders included five patients with enlarged prostate, one patient with BPH, and one patient with elevated PSA results.

The following adverse events possibly related to the use of AndroGel® occurred in fewer than 1% of patients: amnesia, anxiety, discolored hair, dizziness, dry skin, hirsutism, hostil impaired urination, paresthesia, penis disorder, peripheral edema, sweating, and vasodilation.

In this clinical trial of AndroGel®, skin reactions at the site of application were occasionally reported with AndroGel®, but none was severe enough to require treatment or discontinuation of drug.

Six (4%) patients in this trial had adverse events that led to discontinuation of AndroGel®. These events included the following: cerebral hemorrhage, convulsion (neither of which were considered related to AndroGel® administration), depression, sadness, memory loss, elevated prostate specific antigen and hypertension. No AndroGel® patients discontinued due to skin reactions.

In an uncontrolled pharmacokinetic study of 10 patients, there had adverse events associated with AndroGel®; these were asthenia and depression in one patient and increased libido and hyperkinesia in the other. Among 17 patients in foreign clinical studies there was one instance each of acne, erythema and benign prostate adenoma associated with a 2.5% testosterone gel formulation applied dermally.

One hundred six (106) patients have received AndroGel® for up to 12 months in a long-term follow-up study for patient who completed the controlled clinical trial. The preliminary safety results from this study are consistent with those reported for the controlled clinical trial. Table 2 summarizes those adverse events possibly, probably or definitely related to the use of AndroGel® and reported by at least 1% of the total number of patients during long-term exposure to AndroGel®.

Table 2. Incidence of Adverse Events Possibly, Probably or Definitely Related to the Use of AndroGel® in the Long-Term, Follow-up Study

Adverse Event	Dose of AndroGel®		
	5 g	7.5 g	10 g
Lab Test Abnormal*	4.2%	0.0%	6.3%
Peripheral Edema	1.4%	0.0%	3.1%
Acne	2.8%	0.0%	12.5%
Application Site Reaction	9.7%	10.0%	3.1%
Prostate Disorder**	2.8%	5.0%	18.8%
Urination Impaired	2.8%	0.0%	0.0%

*Lab test abnormal included one patient each with elevated GGT, elevated hematocrit and hemoglobin, increased total bilirubin, worsened hyperlipidemia, decreased HDL, and hypokalemia.

**Prostate disorders included enlarged prostate, elevated PSA results, and in one patient, a new diagnosis of prostate cancer; three patients (one taking 7.5 g daily and two taking 10 g daily) discontinued AndroGel® treatment during the long-term study because of such disorders.

DRUG ABUSE AND DEPENDENCE

AndroGel® contains testosterone, a Schedule III controlled substance as defined by the Anabolic Steroids Control Act.

Oral ingestion of AndroGel® will not result in clinically significant serum testosterone concentrations due to extensive first-pass metabolism.

OVERDOSAGE

There is one report of acute overdosage by injection of testosterone enanthate: testosterone levels of up to 11,400 ng/dL were implicated in a cerebrovascular accident.

DOSAGE AND ADMINISTRATION

The recommended starting dose of AndroGel® 1% is 5 g delivering 5 mg of testosterone systemically, applied once daily (preferably in the morning) to clean, dry, intact skin of the shoulders and upper arms and/or abdomen. Upon opening the packet(s), the entire contents should be squeezed into the palm of the hand and immediately applied to the application sites. Application sites should be allowed to dry for a few minutes prior to dressing. Hands should be washed with soap and water after AndroGel® has been applied.

Do not apply AndroGel® to the genitals.

Serum testosterone levels should be measured approximately 14 days after initiation of therapy to ensure proper dosing. If the serum testosterone concentration is below the normal range, or if the desired clinical response is not achieved, the daily AndroGel® 1% dose may be increased from 5 g to 7.5 g and from 7.5 g to 10 g as instructed by the physician.

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COKE: THE COST OF BABYING BOTTLERS

Can CEO Daft ease their plight and please Wall Street, too?

When M. Douglas Ivester was unceremoniously ousted as chief executive of Coca-Cola Co. three years ago, it wasn't the company's beleaguered shareholders who forced him out. While it was the board that sealed Ivester's fate, it was Coke's bitter and angry independent bottlers that prodded directors to oust him. That followed years of tense relations under Ivester, resulting from rippling price hikes, relentless micro-managing, and company-mandated mergers that left some bottlers swimming in debt.

It's no surprise, then, that Ivester's successor, Douglas N. Daft, quickly pledged "to improve bottler economics," when he put it when he became CEO in 2000. For Daft, the biggest challenge in turning around the once-proud beverage giant may hinge on his ability to repair Coke's \$100 billion global bottling network—the companies that buy syrup concentrate from Coke and actually make and distribute the soda. It's becoming increasingly important for Coke to help them out, since some have been distributing more non-Coke brands and pushing through aggressive retail price hikes that boost their profits but reduce the amount of syrup they buy. That explains Daft's burst of bottler-friendly activity: He bought back a majority stake in the troubled German bottling business. He has poured millions in cash into subsidizing other bottlers. He's even given them considerably more freedom to operate. And he has raised concentrate prices far less aggressively than Ivester did.

But can Daft improve his bottlers' plight and still deliver the 10% to 12% profit growth he has promised Wall Street? It will be tough. The whole reason Coke spun off its bottling operations in the 1980s was to offload the low-margin business. And while Coke is on track to generate a return on equity of 38% this year, many bottlers will still post a puny return on equity of 10% or less. "The relationship between

the company and bottlers is inherently unhealthy—has been and remains so," warns Bevmark LLC president Tom Pirko, a beverage consultant. "The relationship has to change, and it won't until Coke is willing to risk its own [returns]." Archrival PepsiCo Inc. has also spun off its bottlers. But analysts say Pepsi, by contrast, enjoys vastly better relations with them because of more equitable contracts.

Coke's bottlers say Daft and his team have made a promising start. "The relationship is like night and day from what it used to be,"

says Lowry F. Kline, chief executive of bottler Coca-Cola Enterprises Inc., which handles 80% of Coke's U.S. sales. CCE will pay just 1% more for concentrate in 2003 than last year, vs. the 7.6% hike in 2000. Daft is also borrowing a page from Pepsi by shifting from universal pricing of syrup, in which bottlers pay Coke a flat fee per gallon. A new formula aligns Coke's concentrate charges to the bottler's success at raising retail prices and, ultimately, bottler profits. "We got rid of the debates about how much Coke should charge us for concentrate," says Irial Finan, CEO of Coca-Cola HBC in Athens, Greece. "If we can't get pricing [at retail], they don't get any increase, either."

Coke is also continuing its subsidies, or "marketing support" payments, to bottlers. CCE is expected to net \$470 million in 2002 on revenues of \$16.8 billion. But without its \$600 million in support payments from Coke, the bottler would be deep in the red. Daft had originally hoped to wind down those pay-



KANSAS CITY BOTTLING PLANT

COKE'S HIGH-MAINTENANCE PARTNERS

CEO Douglas Daft is paying dearly to bolster the beverage maker's flagging independent bottlers

MARKETING SUPPORT

Some bottlers still earn little or nothing, so Daft keeps pumping up their "marketing support" payments. Coca-Cola Enterprises, the largest, gets \$950 million this year.

SYRUP FEES

Bottlers felt burned when Coke hiked the fees they paid for syrup during a retail price war. Now, Daft is rewriting contracts to moderate rises in syrup fees.

ALTERNATIVE INCOME

Daft's predecessor threatened bottlers that sold non-Coke products. Now, Coke is less rigid.

ments. He has since reversed course. On Nov. 8, Coke not only agreed to extend support payments to CCE through 2011 but is also tossing in an additional \$275 million over that time.

Perhaps more important, Daft is giving his bottlers far more freedom. Coke's largest Mexican bottler, Coca-Cola Femsa, recently acquired rights to a popular apple drink, Sidral Mundet, that it now distributes alongside Coke's apple-flavored soda, Lift. "It's better that I have the brand in my hands than in my competitors'," says Femsa CEO Carlos Salazar. That would have been unthinkable a few years back. And to keep bottlers from tying up their trucks with low-volume products such as its Planet Java coffee, Coke may let U.S. bottlers transfer the distribution of these products to local food and liquor distributors while still taking a cut of the profits.

There are risks in this more laissez-faire approach. Some analysts fear that the switch in syrup pricing could hurt Coke. A weaker foreign currency could mean lower local sales and thus less concentrate bought by foreign bottlers. Coke says that won't be the case. And if bottlers no longer fear incurring Atlanta's wrath, some may be tempted to switch from some Coke products to more profitable proprietary brands—for which they don't have to pay a royalty to Coke. "Being an absentee landlord creates its own relationship and system problems that can be equally destructive," says Bear, Stearns & Co. analyst Carlos Laboy. Coke Chief Operating Officer Brian G. Dyson plays down that possibility. "There is more freedom," he says, "but we're not abdicating our leadership role."

In the past, that role has included buying back some troubled bottlers. In March, Coke said it would spend \$600 million to take control of its unhappy German bottler. Now, its biggest Brazilian bottler, Miami-based Panamerican Beverages Inc., is struggling with the \$1.1 billion in debt it incurred under Ivester to merge Brazilian and Venezuelan bottlers. Some analysts think Coke may yet have to take over Panamerican's Brazilian business or sell it off piecemeal to other Coke bottlers. But Panamerican has a new CEO, who Coke believes is making headway. And Coke's chief financial officer, Gary P. Fayard, says: "I think we're pretty much over the hump. Over the next couple of years, we will be a net seller [of bottling operations]." Until then, Coke's problem remains how to put the fizz in the bottlers without seeing its own profits go flat.

By Dean Foust in Atlanta, with Geri Smith in Mexico City

People

EXECUTIVE SUITE

PROTECTING FANNIE'S FRANCHISE

CEO Raines will need all his political savvy to ward off reforms being pushed by a jealous banking industry

Amid Capitol Hill's post-Enron fascination with corporate governance earlier this year, Representative Christopher Shays (R-Conn.) figured that forcing mortgage giant Fannie Mae to start registering with the Securities & Exchange Commission would be a no-brainer. The first hint that he might have underestimated Fannie and its politically savvy CEO, Franklin D. Raines, came from Representative Richard Baker (R-La.), a longtime nemesis of Raines. Baker, who chairs the House capital-markets, insurance, and government-sponsored enterprises subcommittee, warned Shays, new to his panel, that he might have bitten off more than he could chew. Shays recalls: "I looked at him, thinking to myself: Give me a break. We just got through passing campaign-finance reform. Everything else will be a cakewalk. But Richard gave me this knowing smile like, 'Rookie, you don't even know what you're getting yourself into.'"

Sure enough, the folks at Fannie eerily got word of Shays's plan and immediately called his office to set up a meeting with Raines. Shays says they never connected, and he went ahead and introduced the legislation. Immediately, each House member received a letter saying that more than two dozen groups—from the National Association of Realtors to the National Council of La Raza, an advocate for Hispanic Americans—opposed the bill on the grounds that it would harm consumers. It went nowhere. "I felt like I kicked

a hornet's nest," says Shays.

Chalk up another win for one of Washington's most polished players. Raines has become a master at the art of wielding an iron fist inside a velvet glove. With charm, impeccable connections, and understated arm-twisting, he repeatedly staves off attacks by industry rivals determined to blunt what they believe is an unfair advantage stemming from Fannie's quasi-public status. "Frank Raines runs the most sophisticated political



FannieMae

operation in the universe," says a White House insider. Raines, 53, takes this as a compliment. "We pay a lot of attention to political risk because our competitors want to change the landscape," he says.

Probably no other big-company CEO worries so much about wooing official Washington, and for good reason: Fannie's charter can be changed at the whim of Congress. Fannie was created in 1938 by President Franklin D. Roosevelt to revive the housing market by buying mortgages from struggling lenders, enabling them to lend more. Congress converted it into a government-sponsored private enterprise in 1968. Today Fannie is the second-largest U.S. corporation, based on assets of \$838 billion, behind Citigroup. It owns 11% of the nation's mortgages.

Fannie doesn't actually lend money, however. It buys mortgages with money

WHEN YOU'RE RAINES, IT POURS

Fannie Mae CEO Frank Raines is facing challenges on a number of fronts:

DISCLOSURE

Early next year, the Treasury Dept. and the SEC are expected to release a study that will include ways to increase disclosure of Fannie's credit risks

CONGRESS

Rep. Richard Baker, a time critic, plans to hold hearings on Fannie's management next year and offer a bill to strengthen the company's regula-



ed through debt offerings—borrow-
at lower rates than others because
a presumed federal guarantee of its
t. This allows it to profit on the dif-
ference between the rate on the mort-
gages it buys and the rate on the debt
issues. A larger but less profitable
part of its business involves packaging
mortgages into mortgage-backed secu-
rities and selling them to investors.

It's the benefits Fannie derives from
this unusual public-private setup that
has Raines in the spotlight. Powerful
commercial banks such as Wells Fargo,

WALL STREET

Fannie has reassured
in recent months
its ability to manage
its mortgage portfolio, polit-
essure has caused its
stock price to drift lower

J.P. Morgan
Chase, and GE
Capital—the
latter is based
in Shays's dis-
trict—fear
that Fannie is
straying from
its mandate
of stimulating

the housing market. They
are sure to make another
run at getting Congress to
revoke Fannie's \$2.25 billion
conditional line of credit with
the Treasury. They also want
Fannie to disclose to the SEC
details about its mortgage-
backed securities, which it
issues by the truckload each
year. And they want Fannie to start pay-
ing state and local taxes, from which it is
now exempt.

The Congressional Budget Office says
those privileges amounted to \$6.1 billion
in 2000. Fannie disagrees with the CBO's
methodology, calling the figure closer to
\$3 billion to \$3.6 billion. Either way, it's a
key reason Fannie has delivered double-
digit profit growth for the past 16 years.
This year, Fannie should generate oper-
ating net income of \$6.3 billion, says San-
ford C. Bernstein & Co. analyst Kevin J.
St. Pierre. He expects that to rise 11%

THE HOME FRONT

Raines acts
quickly when
Fannie is under
threat: "We pay a lot
of attention to
political risk"

next year. Raines himself
made \$6.9 million last year
in salary, bonus, and other
compensation, says Fannie,
not including 277,335 new
stock options he received.

The GOP's election gains
will only turn up the heat
on Raines's money machine.
Incoming Senate Banking

Committee Chairman Richard C. Shelby
(R-Ala.) is more likely to go along with
efforts to reform Fannie than his pre-
decessor, Paul S. Sarbanes (D-Md.), ever
was. And Baker is still on the war path.
"Whereas Democrats want Fannie to
expand their activities, Republicans
want them to limit their risk," says
Andy Laperriere, a Washington-based
managing director of ISI Group. Since
the election, Fannie's stock price has
dropped 7%, to about \$63.

Even before November, though, Wall
Street was worried about Fannie's abil-

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Access allows customers, employees, and partners to securely connect to business processes and customer information securely from anywhere at any time, whether it's a laptop, a PDA, a cell phone, or any other touchpoint.

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"CRM in The Real-Time Enterprise is all about reducing costs, reducing delays, and bringing new revenue-generating opportunities into focus," says Davis. "Ultimately, it's the intelligent integration of complex technologies to make things simple."

COMPANIES ARE TAKING ADVANTAGE OF THESE CAPABILITIES TODAY:

ABN AMRO uses PeopleSoft's CRM solution to drive new business within its customer base. "The PeopleSoft CRM pure Internet platform provides our customers, suppliers, and employees access to our Netherlands banking operations through any Web device anywhere in the world, at any time," says Dolf Collee, ABN AMRO board member. "Employees now have a real-time comprehensive view of customers, making them more effective in resolving inquiries and acting on cross-sell and up-sell opportunities. Customers will have direct access to new products and services through multiple distribution channels resulting in more personalized service."

Fairchild Semiconductor's global internal and external sales teams use PeopleSoft Sales to maximize their selling opportunities. Fairchild employees and sales representatives around the world use PeopleSoft Sales to accelerate the sales process, influence buying decisions, and obtain real-time insight into opportunity information. "Now our salespeople have visibility into the most strategic opportunities," says John Henshaw, director of eBusiness, Fairchild Semiconductor. "And it allows our executive management team to see pipeline and competitive information, so they can make decisions in real time, based on information collected across the enterprise."

PepsiAmericas relies on PeopleSoft CRM and Order Management to combine customer information across its enterprise and give real-time access to its telesales agents. "PeopleSoft CRM gives a 360-degree view of our customers to the people in our enterprise who need it," says Ken Johnsen, PepsiAmericas Vice President and Chief Information Officer. "The Internet architecture is easy to deploy and that not only helps us lower our cost of ownership—it is also helping us get closer to our customers." As a result of operating in real time, PepsiAmericas not only knows its customers much better but also has lowered costs by streamlining deliveries and enhancing customer satisfaction—ultimately increasing its competitiveness.

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ity to manage its risk. Opponents say the company discloses very little about the derivatives it uses to hedge against gyrating interest rates. They want to know more—like who its counterparties are, and the extent to which Fannie is hedged. “Nobody knows how much hedging they’re doing and whether their derivatives will be effective,” says Peter J. Wallison, a resident fellow at the American Enterprise Institute think tank. Federal Reserve Chairman Alan Greenspan raised the issue this spring, warning that firms selling derivatives to Fannie may take on too much risk because of the perception that it has government backing. Raines counters: “Our counterparties apply very rigorous controls. If we run up against their risk limit, they don’t do more business with us.”

Investors became alarmed last September when they saw a sharp widening of the most-watched index of Fannie’s interest-rate risk—the “duration gap” between the expected lifetimes of its mortgage assets and its debt liabilities. Fed by a wave of mortgage refinancings, as homeowners snapped up lower rates, the gap swelled to the point where Fannie’s assets would mature 14 months before it paid off its debt. That was the widest ever.

But since then, Raines has shrunk the gap, to six months, by buying mortgages. That lowered Fannie’s prepayment risk, since new mortgages carry lower rates and are less likely to be refinanced right away. Raines says that’s a perfect example of why he’s not worried about Fannie’s exposure or the risk it could pose for the major institutions that hold its shares, including many mutual funds. “What is the cure? We buy mortgages. Then we’re back in the comfort zone.” But if the housing market comes back to earth, won’t he have fewer mortgages to buy—and less room to maneuver? Raines is dismissive: “Between population growth, immigration, baby boomers hitting their peak homeownership years, [and] house price increases, our market is going to double over the next 10 years.”

Indeed, the smart money in Washington and on Wall Street says that

Fannie will once again survive with only a few nicks in its hide. How does Raines do it? He starts with a golden Rolodex, stocked with the names of former colleagues from his old Wall Street firm, Lazard Frères, and two years as budget director in the Clinton Administration. Since becoming CEO in 1999, he has hired plugged-in members of both parties—top staff from Congress and the executive branch—to enhance Fannie’s political influence. That in-

FRANKLIN D. RAINES

BORN Jan. 14, 1949, Seattle.

EDUCATION BA, government, magna cum laude, Harvard University, 1971; attended Magdalen College, Oxford University as a Rhodes Scholar 1971-73; JD, cum laude, Harvard Law School, 1976.

UPBRINGING One of seven children born to parents who didn’t finish high school. His father, Delno, a city custodian, dug the foundation for the family home by hand.

CAREER PATH Spent 11 years at Wall Street firm Lazard Frères, where he was general partner, before becoming vice-chairman of Fannie in 1991. Served as President Clinton’s director of the Office of Management & Budget, 1996 to 1998.

CURRENT JOB CEO of Fannie Mae since 1999.

FIRST BRUSH WITH POWER At age 20, as a White House intern for Daniel Patrick Moynihan, then President Nixon’s urban affairs adviser, Raines made a presentation to Nixon and the Cabinet on the Vietnam War protests. Returned to Washington in 1977 to serve as associate director for economics and government in the OMB under Jimmy Carter.

FAMILY Married to wife, Wendy, for 20 years; three daughters.

cludes Arne Christenson, chief of staff to former House Speaker Newt Gingrich (R-Ga.) and now Fannie’s senior vice-president for regulatory policy.

Raines also knows when to bend. When Fannie was accused this summer of being too secretive, he volunteered to give up one of its statutory exemptions and register its common stock with the SEC. By law, Fannie wasn’t required to do so because of its public mission of providing liquidity to the mortgage market. He knew Fannie’s refusal to file quarterly SEC reports would not sit well with the Bush Administration.

Still, the move was only a tactical retreat. Raines persuaded the SEC not to

force Fannie to register its mortgage-backed securities, as other issuers must do. This deprives buyers of such crucial information as where mortgaged properties are located and the creditworthiness of the home buyers. Raines argues that the number of securities Fannie issues—40,000 mortgage-backed securities in 2001 alone—would overload the SEC and hurt liquidity in the mortgage market. He may face renewed pressure in early 2003, when the SEC and the Treasury Dept. will release a study expected to suggest ways to improve the firm’s disclosures.



That Fannie Mae still retains the privileges conferred upon it in the 1930s enrages bank competitors who three years ago formed a watchdog group, the Mortgage Watch. “Their whole premise is, ‘We’re the American Dream Company.’ We dream on,” says Edwin Rothschild, an FM Watch

consultant. “They’re much more concerned about their bottom line.” Raines counters by working closely with local nonprofit and lawmakers to encourage lenders to loan to minorities. Fannie then agrees to buy the loans. In fact, Raines recently made a commitment to invest \$700 billion through 2009 to provide financing to 4.6 million minority households.

Interwoven with the Fannie legend is the personal story of Raines. He grew up in Seattle, one of seven children born to parents who didn’t finish high school. His father, Delno, a city custodian, dug the foundation for his family’s house by hand, paid the state \$1,000 for a house that was about to be torn down, and

used the lumber to build a new home. Over five years, he put in the drywall and the wiring. When he died, he left Raines’s mother left \$300,000, a hefty sum since neither made more than \$15,000 a year. “It’s a dramatic demonstration of how important access to capital and homeownership are in the lives of working-class people,” Raines says.

Critics say that, for all the good it does, Fannie is leveraging its privileged status to mint money at the expense of the private sector. The company’s real expertise? “They are, without question, the most effective managers of political risk in America,” says Baker. What is exactly the effect Raines hopes to have on the new Congress, too.

By Laura Cohn in Washington



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STATES

TO THE VICTORS BELONG THE BUDGET MESS

Bare cupboards await the new platoon of governors

During the Prosperity Decade of the 1990s, life was sweet at the governor's mansion. Gushers of revenue let states slash taxes while spending generously on schools, health care, and seniors. And it's no accident that four of the five past Presidents came from the governors' ranks.

Now, 24 new governors are about to take office—and some may want to follow the path of George W. Bush and Bill Clinton. But before they get from the statehouse to the White House, they'll have to confront a harsh reality: Collapsing tax revenues and exploding costs, especially for health care and education, have hit budgets with a double whammy. And this across-the-country crisis may make or break the Class of '02.

States in tatters is quite a change from the good times. From 1992-2001, overall state spending grew by 5.8%. In the last six years of the decade, taxes were slashed an average of \$4 billion a year. And employment in the '90s rose by 20%—almost all in education.

Since the boom went ka-boom, spending has slowed markedly, rising barely 1.3% in the past two years. But Medicaid, the health-care plan for the poor, is still growing by over 12% a year and now eats up 20% of state budgets. Meanwhile,

education costs remain high, and states are struggling to use technology to cut operating costs.

States have been battered by the stock market, too. Tax revenues from capital gains and stock options have plunged even as pension funds have been hammered by market losses.

In the past year, states struggled to close a fiscal gap that topped \$50 billion. When lawmakers resume work in January, the situation could be worse. And unlike the feds, states must balance their budgets each year (box).

"It's a tremendous challenge," says South Carolina's new chief executive, Mark Sanford (R).

One reason the task is so daunting: The easiest steps have already been taken. During the past three years, many states

avoided painful tax hikes or spending cuts by tapping rainy-day funds. But they've drained those balances down from \$49 billion to less than \$15 billion according to the National Governors' Assn. In states with new governors, including Illinois, South Carolina, and Wisconsin, reserve-fund gauges read "empty." Says Iris J. Lav, deputy director of the Center on Budget & Policy Priorities, a Washington think tank, the question for many new chief executives is: "O.K. buster, what are you going to do now?"

Not only must states address the 2004 budgets but nearly half must also clean up their '03 books, which remain \$17 billion in the red. One reason: Lame-duck governors and those running for reelection ignored growing shortfalls. Maryland, incoming Governor Robert Ehrlich Jr. has to tackle a \$1.2 billion deficit for fiscal '04, plus a \$600 million shortfall. In Minnesota, Republican Tim Pawlenty must find \$500 million for '04 before he fills a \$1.6 billion hole in '04.

To complicate matters, nearly every new governor—Democrat as well

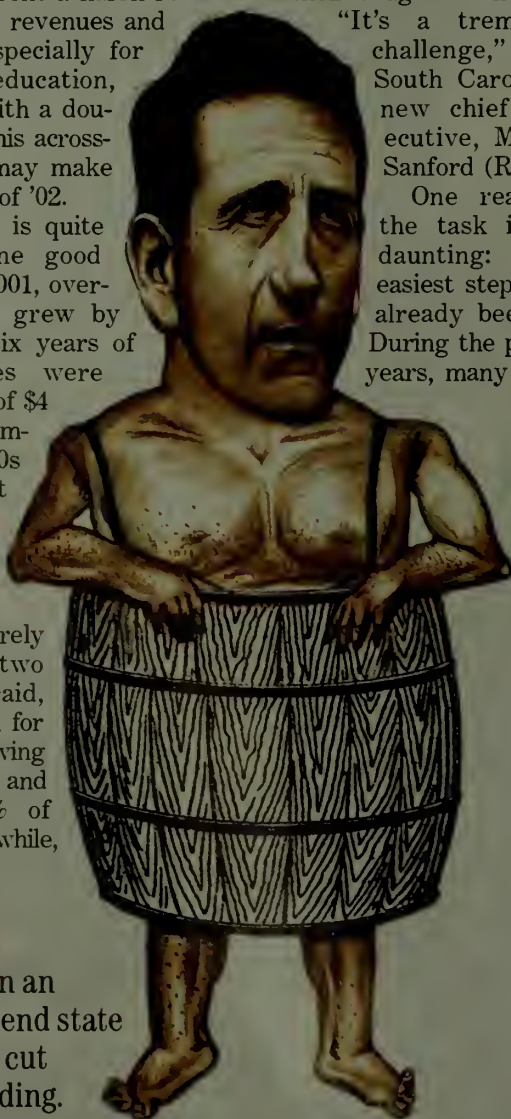
Republican—has sworn off tax hikes. Democrats such as Illinois' Rod Blagojevich and Wisconsin's Jim Doyle won part by convincing voters they would not raise taxes. And most soft-peddled business tax hikes. South Carolina's Sanford even vowed to abolish the income tax. In Massachusetts, which elected anti-tax Mitt Romney, voters nearly defeated that themselves. A referendum to end the Bay State's income tax almost passed.

Romney is up against a shortfall of up to \$2 billion in the fiscal year beginning next July. And that's despite \$1.2 billion in tax hikes and \$1 billion in spending cuts this year alone. Says Michael Widmer, president of the Massachusetts Taxpayers Foundation: "This is the worst fiscal crisis in at least 50 years."

To help close the gap—and give himself some political

MARK SANFORD, SOUTH CAROLINA

Republican ran on an ambitious vow to end state income tax. Must cut \$1 billion in spending.



JENNIFER GRANHOLM, MICHIGAN

Democrat faces a projected deficit of \$1.5 billion—and a new \$1 billion tax cut will kick in on Jan. 1.



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cover—Romney has asked some high-profile execs, including Staples Chairman Thomas G. Stemberg and Fidelity Investments Vice-Chairman Peter Lynch, to suggest solutions. On the table: a broad government restructuring that may shift much state work to private contractors. The biggest target may be the massive Health & Human Services Dept. But to enact reforms, Romney must deal with an aggressive and overwhelmingly Democratic state legislature.

Such partisan wars will break out all over. Maryland's Ehrlich, a Republican, must battle a Democratic legislature. In Michigan, newly elected Dem Jennifer M. Granholm will wrestle with a GOP-dominated statehouse.

Granholm faces an '03 deficit of at least \$500 million and an estimated \$1.5 billion shortfall for '04. Michigan expects to be \$275 million short on Medicaid funding, which is shared by the states and the feds. In Illinois, Blagojevich must struggle with a \$600 million hike in health costs—for both Medicaid and state employees. Overall, according to the National Association of State Budget Officers, at least 41 states expect to run out of Medicaid money this year. Next year, Congress may ease

MITT ROMNEY, MASSACHUSETTS

GOP star vows no new taxes to close a budget deficit of up to \$2 billion. On Nov. 5, voters almost abolished the state's income tax.

the problem by giving states about \$5 billion, but it won't be enough.

Michigan raised cigarette taxes by 50¢ a pack last summer, but Granholm will find it tougher to hike taxes. "Increasing taxes isn't on most people's radar screens," says Tom Clay, senior associate at the Citizens Research Council of Michigan, a fiscal watchdog group. Indeed, the state has big income tax cuts scheduled for 2003 and 2004 and no plans to delay them.

South Carolina's Sanford has taken the anti-income tax sentiment a step further: He would wipe out the levy over the next 18 years. But he still must close a \$331 million deficit this year and deal with a shortfall of twice that next year. He's calling for management

reforms and wants to subject gasoline to the state's 5% sales tax.

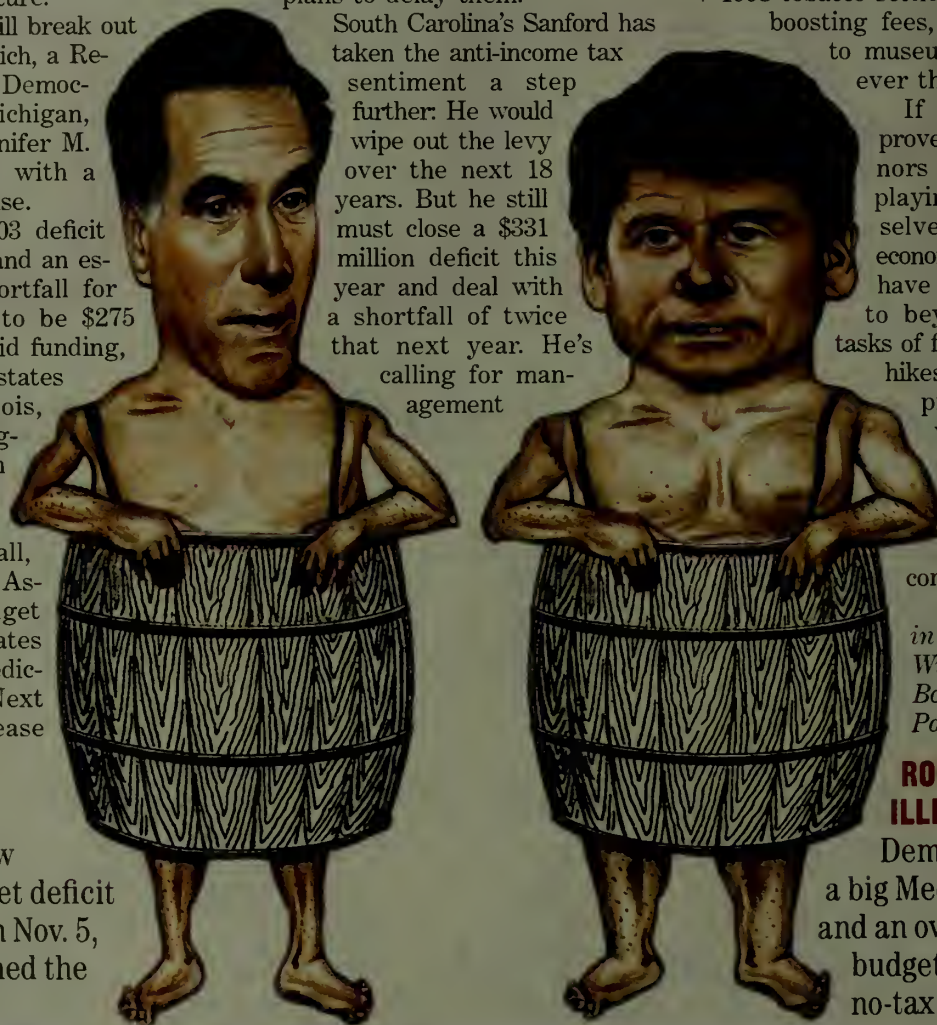
Unable or unwilling to hike taxes, new governors are looking to more unusual sources of revenues. Ehrlich wants to put slot machines in Maryland's racetracks (BW—Dec. 2). Pennsylvania Democrat Ed Rendell would use state revenues to reduce property taxes. Massachusetts may borrow against some of the \$8 billion it's owed as part of the 1998 tobacco settlement. And states are boosting fees, from college tuition to museum admissions, wherever they can.

If revenues don't improve soon, the new governors may want to start playing the slots themselves. Without a quick economic turnaround, they have little to look forward to beyond the unpleasant tasks of finding stealth revenue hikes and slashing popular programs. That's the way to build a political future. And it may explain why even a politician's onetime dream job has become a nightmare.

By Howard Gleckman in Washington, William C. Symonds in Boston and Ann Thorne Palmer in Chicago

ROD BLAGOJEVICH, ILLINOIS

Democrat must battle a big Medicaid funding gap and an overall \$500 million budget shortfall. Took a no-tax pledge.



THE STATE DRAG ON THE ECONOMY

WHY ARE THE STATES IN SUCH A FISCAL MESS?

States face a vicious cycle: They have been pummeled by falling revenues and skyrocketing costs, especially for health care. As a result, they have to find ways to cut spending and raise taxes to balance their budgets.

WHY BOTHER TO CLOSE THE GAP? THE FEDS DON'T

Nearly every state is required by law to balance its budget every year. Plus, the states can't print money the way Washington can. So while the federal government can borrow and spend or borrow to cut taxes, states cannot.

HOW BIG IS THE PROBLEM? It hasn't been this bad in 20 years. The state revenue shortfall over the past couple of years has topped \$50 billion. And the news isn't much better for the coming fiscal year. California

alone now expects a staggering deficit of \$21 billion.

WHY IS THAT SO BAD FOR THE ECONOMY? States are zigging while the feds are zagging. Even as Washington is busily stimulating the economy by cutting taxes and spending more, states are dragging growth down by raising taxes and cutting their spending.

IS THERE A SOLUTION? Congress tried to shift about \$9 billion to the states to help pay for Medicaid, the health-care program for the poor. The effort was opposed by the White House and failed. In the short run, Congress can try again. But the best long-term fix may be to transfer Medicaid—which is now funded by both the states and the feds—entirely to Washington. That would lift a huge fiscal burden from the states.

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A photograph showing the lower halves of two children jumping on a bed with white linens. The child on the left is wearing blue patterned shorts, and the child on the right is wearing blue and white patterned shorts. A small red toy car is on the bed between them.

be spirited

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A photograph of a Sharp AQUOS flat-panel television on a black stand in a living room. The TV screen shows a horse running. To the left of the TV is a small table with a vase of red flowers.

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BY MARCIA VICKERS

On the morning of Jan. 14, 2002, the Park Avenue offices of Oscar-winning money manager Kenneth Lipper were uncannily quiet. It was 9:30, the start of the trading day, but the fund manager and the research director who ran Lipper & Co.'s \$2.8 billion hedge fund, Lipper Convertibles LP, were nowhere to be seen. Their desks, which stood just a few feet from Lipper's own expansive, glass-walled office, were curiously neat. Gone were the usual scribbled notes, crumpled papers, and half-filled coffee cups. A phone emitted a constant, low-pitched buzz. The two men had turned up early that morning, resigned, and left abruptly—without any explanation. Lipper, a former New York deputy mayor, was out of the office too that day, working in Hollywood on a film he was producing and meeting with some of his hedge-fund clients.

Cover Story

Abraham Biderman, executive vice-president at the firm and Lipper's right-hand man, was alarmed. Why had the traders, Edward Strafaci and Michael Visovsky, jumped ship? He knew that Lipper & Co.'s longtime auditor, PricewaterhouseCoopers, was planning its annual audit soon and would be questioning "the boys," as several co-workers called them, about trades they had made. Biderman was also aware that Strafaci and Visovsky had pocketed their annual bonuses just days before. Biderman started to panic. Soon, his worst fears were confirmed: Strafaci and Visovsky had left behind a trail of unanswered

SUSAN WERNER

THE FALLEN FINANCER





ER

KEN LIPPER wanted to be a big wheel in Hollywood and New York. But he may be remembered most for the collapse of his hedge fund empire—and huge losses for the rich and famous

questions about a securities portfolio that was in tatters.

It wasn't until a month later that Lipper dropped the bomb on his investors, many of them his famous and powerful friends from the worlds of entertainment, politics, and Wall Street—such as actor Julia Roberts, Walt Disney CEO Michael D. Eisner, Senator Ernest F. “Fritz” Hollings (D-S.C.), the family of financier Henry Kravis, and publishing and real estate tycoon Mortimer

Cover Story

Zuckerman. In a Feb. 20 letter to investors, Lipper disclosed that Lipper Convertibles had lost “in the neighborhood of 40%” of its value, or about \$315 million, in 2001, instead of the 7.7% gain the firm had reported near the end of the year. The hit to Lipper’s \$4 billion empire of money, hedge, and mutual funds was so serious that it would eventually force the 16-year-old firm under.

Lipper & Co. is now liquidating all of its hedge funds and mutual funds. It has also sold its \$500 million high-yield-bond business because of the debacle. The firm has acknowledged that it is being investigated by the Securities & Exchange Commission. Sources say that the FBI is also conducting an inquiry. If the government pursues a case, Lipper could be charged with failure to supervise his traders or even with fraud—and if he is found liable, it could cost him his career in the securities industry. If criminal charges are upheld, he could possibly land in jail, say sources close to the SEC probe.

Ken Lipper’s fall epitomizes a tumultuous chapter on Wall Street. He was a creature of the times—at home in the

‘A RENAISSANCE MAN WITH THE MIDAS TOUCH’

Lipper, the bright son of a shoe salesman, spent his childhood in the South Bronx. A scholarship kid, he made **PHI BETA KAPPA** at Columbia and earned law degrees at **HARVARD** (right) and NYU.



“greed is good” precincts of Wall Street and comfortable running with a fast Hollywood and Manhattan crowd. The ruddy-complexioned, fuzzy-haired Lipper may be best known to some as an adviser on Oliver Stone’s 1987 movie *Wall Street*. But he has also carefully crafted the image of a Renaissance man with the Midas touch. Lipper has flitted, almost *Zelig*-like, through the worlds of investment banking, politics, money management, movie production, philanthropy, and book publishing. In the mid-’80s, he was Edward I. Koch’s deputy mayor. In 1999, he even won an Academy Award for *The Last Days*, a documentary about the Holocaust that he produced with Steven Spielberg.

The flashy pitchman with his fancy connections and wealth was a magnet for investors who never questioned his ability to manage their money. According to one investor: “He would say, ‘You’re investing alongside me and my family.’” Recalls

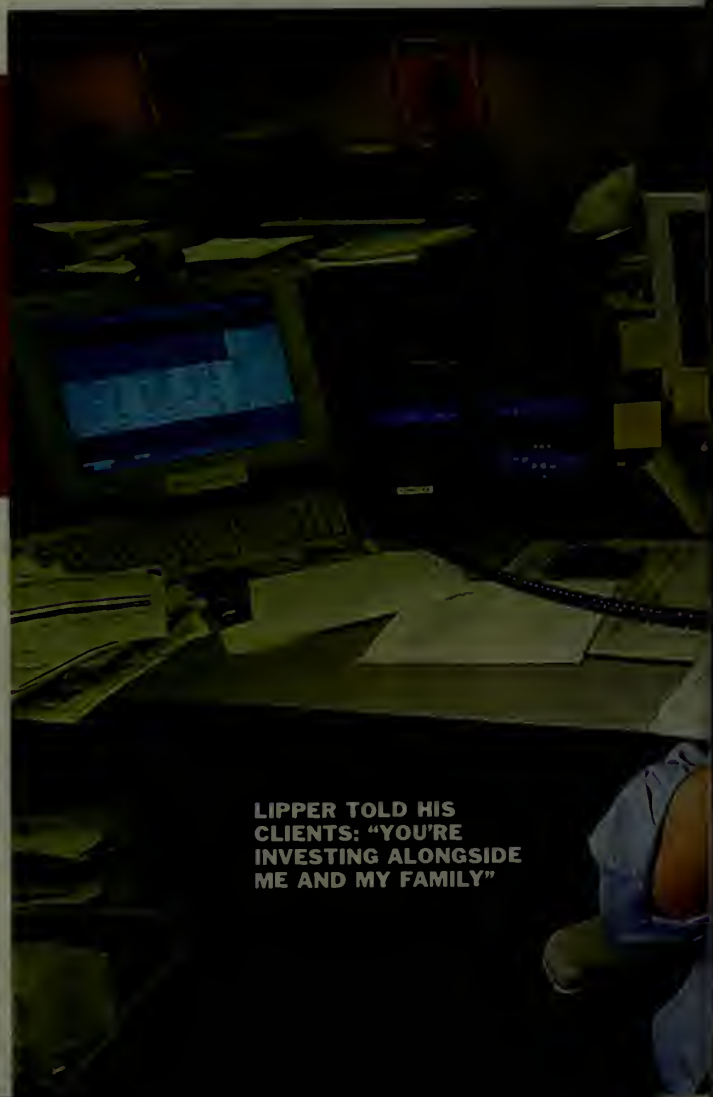
LIPPER’S LOSERS?

Many A-list clients of Ken Lipper’s \$4 billion empire could be nursing substantial losses as a result of the debacle



another: “I was told repeatedly that the fund was like ‘high-powered’ savings account.” The Hollywood crowd, especially, trusted Lipper, a former partner at both Lehman Brothers Inc. and Salomon Brothers. Says an insider: “They were rich—but largely financially ignorant—people who were wowed by his blue-chip Wall Street credentials.”

They should have taken a closer look. Documents obtained by *BusinessWeek* show that Lipper Convertibles, an arbitrage fund set up to buy the convertible bonds of companies and simultaneously sell their stock short as a hedge, was marketed as a conservative investment. But it held a large number of highly speculative securities and was heavily leveraged. Described in the prospectus as a “market-neutral” fund that aimed to make money whether the stock market rose or fell, it wasn’t hedged properly. What’s more, although auditors PwC signed off on its accounts, Lipper & Co. had probably been mispricing the fund as far back as 1995, according to an Oct. 3 internal report by accountants BDO Seidman LLP. Nevertheless, Steven S. Ber, a PwC spokesman, says the firm does not comment on



LIPPER TOLD HIS CLIENTS: “YOU’RE INVESTING ALONGSIDE ME AND MY FAMILY”

EL EISNER, chairman and CEO
t Disney

MER ZUCKERMAN, chairman
ditor-in-chief, *U.S. News &
Report*

RANKEL, former executive
The New York Times

y of **HENRY KRAVIS**, head of

buyout firm **Kravis Kohlberg Roberts**

The blind trust of Senator

ERNEST F. "FRITZ" HOLLINGS (D-S.C.),
outgoing chairman of the Senate
Commerce Committee

Investment funds of the **UNIVERSITY
OF MINNESOTA** and **GEORGE
WASHINGTON UNIVERSITY**

WILLIAM J. McDONOUGH New York
Federal Reserve Bank chairman

TISCH FAMILY The dynasty that
controls Loews Corp.

Actors **JULIA ROBERTS AND
DANNY AIELLO**

AGNELLI FAMILY Owners of Italy's
carmaking-to-finance empire

Data: Court documents, *BusinessWeek*

ent matters. (Lipper & Co. is not related to the fund research
company Lipper Inc., which is part of Reuters Group PLC.)

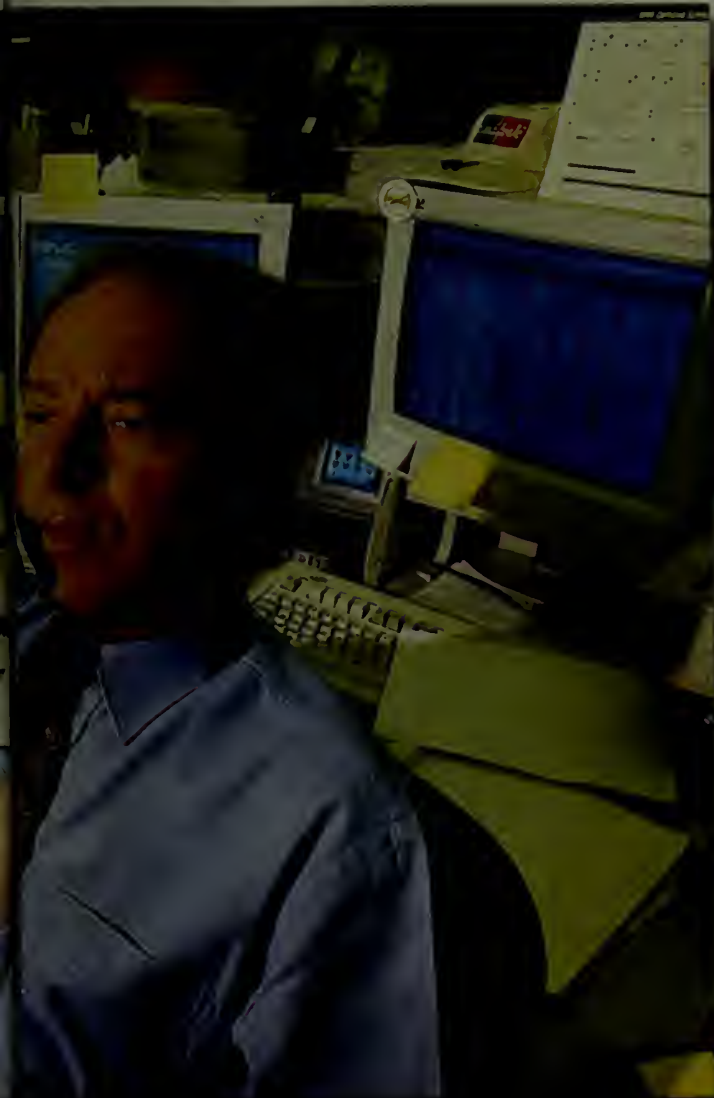
Some investors allege that Ken Lipper may have known
about the mispricing for months before telling his clients. An
affidavit filed by one investor on May 15 in the New York
State Supreme Court says that in late 2001 Lipper called him
home in the evening, attempting to persuade him to switch
out of the troubled convertible arbitrage fund into a new dis-
cussed-securities fund. "In my opinion, it's almost inconceiv-
able that Lipper—who had millions of his own dollars, as well
as his family's money, tied up in the fund—didn't know about
any of this stuff sooner," says Leslie Akins, a lawyer for
one of Lipper's investors. Biderman says Lipper was "abs-
olutely, categorically unaware" of any mispricing prior to
Strafaci's and Visovsky's departure and the resulting internal
investigation. Lipper had tens of millions of his own money in
the funds, say sources.

Lipper, who declined numerous interview requests by *Busi-
nessWeek*, has maintained his innocence in letters to investors,

at first blaming the demise of the fund on market woes and
"the extraordinary combined severity of 2001 events." But he
also pointed a finger at his traders, Strafaci and Visovsky, say-
ing that their abrupt exit led the firm to conduct its own in-
vestigation, which concluded that "a more cautious valuation
was warranted." In a follow-up letter on Mar. 26, Lipper told
investors the fund had fallen 47% since Dec. 31, 2000.

Some of Lipper's powerful friends support him. Says John
H. Gutfreund, former CEO of Salomon and Lipper's boss back
in the late '70s: "I don't think I would blame this on Kenny.
He had the wrong guys running the fund." Biderman says:
"Lipper absolutely, categorically was not aware of any of
the fund's problems." However, one investor's lawyer sarcas-
tically labels Lipper's explanations as possibly "another Oscar-
worthy performance." And Strafaci rejects Lipper's claims.
"We don't bear any responsibility at all," he says. "Clients
have to go to Ken Lipper if they're mad—he was the CEO."
Visovsky didn't return phone calls.

Many of his investors are furious. At least two—Race
Rock Corp., a private investment firm, and Mesorah Heritage
Foundation, a Jewish charity—have filed suits in the New

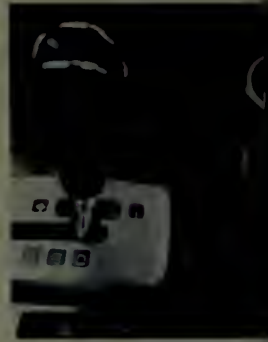
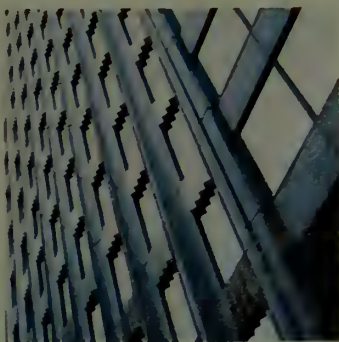


After a brief stint in law
and the Commerce
Dept., he joined **LEHMAN
BROTHERS** as an
investment banker in
1969. He soared to
become, at 32, one of
the firm's youngest
PARTNERS ever.

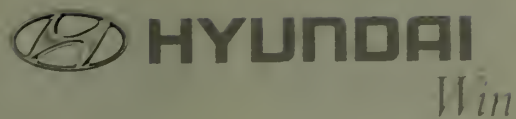
In 1976, he jumped to
SALOMON BROTHERS, his
smarts making him a
much-sought-after
dealmaker. He made
millions cashing out
when the bank went
public in 1982. >>>>

York State Supreme Court and the U.S. Bankruptcy Court in
the Southern District of New York, respectively. Race Rock's
suit, which sought details of the fund's investments, alleged
that in the months after the valuation bomb was dropped, the
company's strategy was to "delay, evade, conceal, deceive, and
finally refuse" to give out information. Lipper & Co. subse-
quently supplied some of the requested information.

On Oct. 4, Lipper & Co. sent a distribution plan to in-
vestors for the liquidation of Lipper Convertibles. Many are
hopping mad because, they say, the plan favors those who
entered the fund recently over longer-term clients. Investors
have filed more than 20 letters of objection to the plan. One of
them, according to court filings, is Lipper's ex-wife, Evelyn
Gruss, a respected developmental pediatrician who had kept
money with Lipper after their divorce in 2000. A hearing in the
New York State Supreme Court, originally scheduled for Dec.
5, was postponed until Jan. 7. "You're going to see more law-



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When you sing to the radio

When you have a backup route

When you use the time to prepare for work

When you use the time to forget about work

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suits fly after the hearing," says an insider. "This could ruin Ken Lipper."

Already, Lipper is reeling from personal financial woes. His publishing venture with Viking Books, the Lipper/Viking Penguin Lives Series, in which renowned authors such as Larry McMurtry and Jane Smiley wrote biographies of historical luminaries such as Crazy Horse and Charles Dickens, started to unravel this

Cover Story

summer when Lipper stopped funding it. His pal Roger Altman, a former deputy Treasury secretary who now runs an investment banking boutique, later stepped in as a white knight to keep the critically acclaimed project going. Marshlands, Lipper's 30-acre spread in Southampton, N. Y., which he bought for around \$9 million after his divorce, was put on the block last summer for \$18 million. The house—which Lipper was in the middle of renovating and which has features such as a boat launch underneath allowing direct access to a speedboat—later sold for \$10 million.



Now rich, Lipper dived into New York politics as a top finance adviser and **DEPUTY MAYOR** under Edward Koch (right). Resigning to run for City

Council president, Lipper lost to **ANDREW STEIN** in a fight still remembered as one of the city's nastiest ever. >>>>

Next to Lipper's sizable bank accounts, the glitterati he hobnobbed with, such as Spielberg and Robert DeNiro, were his biggest assets. He adroitly used his impressive credentials and fancy connections to attract big money to his firm, some sources say. "His connections were like gold to him," says a longtime friend. Lipper's investors were strictly A-list, too. Sources say that, in addition to Roberts, Eisner, Hollings, and Zuckerman, the roster included Lipper's pal William J. McDonough, chairman of the New York Federal Reserve; actor Danny Aiello; Italy's Agnelli family, of Fiat fame; various entities of the Tisch family, owners of Loews Corp.; and some members of the Rothschild banking family. Other than Kravis, who says he withdrew from the fund before the losses occurred, none would comment. A lucky few had invested in Lipper's offshore convertibles fund, which suffered only 10% losses.

Hollywood retirement funds, such as the Motion Picture In-

dustry Pension Plan and the fund for Creative Artists Agency, had at one time invested with Lipper, along with several religious charities and educational institutions, according to marketing materials obtained by *BusinessWeek*. True money for Lipper's four daughters is tied up in the fund, sources say. Ed Koch, a former investor, says he was lucky enough to withdraw his money before Armageddon came. "Clearly, there are people who have suffered large losses. It's all very sad. I'm sure this has hurt Ken personally—his pride as well as his finances," he says.

Critics say they believe Lipper, who pocketed a standard yet-hefty 20% hedge-fund performance fee, didn't seem sufficiently involved in whether the money was properly invested. "It seems Lipper was basically asleep at the wheel," says a fund-of-funds manager. Others are harsher. Sam Michael Ocran, editor of *MarHedge*, a hedge-fund newsletter, says "Lipper most likely knew these traders were mispricing the portfolio and juicing the returns all along. But he was so concerned with his reputation and impressing his celebrity clients that he allowed it, until they just got in too deep to recover."

It was pure hubris," Biderman rejects that view. "Lipper was absolutely, totally involved in the business on a daily basis," he says. Asked by *BusinessWeek* how this could have occurred, Biderman says: "There will be an appropriate investigation that we will deal with that."

Lipper, a 61-year-old, boyish-looking bon vivant, grew up in the South Bronx, the bright son of a shoe salesman. Friends say "The Lip," as he sometimes called ("he loves to hear himself talk," says one), is a consummate self-starter with a fiercely competitive spirit. He attended both C

KOCH AND PROTEGE: TODAY, THE EX-MAYOR SAYS: "IT'S ALL VERY SAD. I'M SURE THIS HAS HURT KEN PERSONALLY—HIS PRIDE AS WELL AS HIS FINANCES"



olumbia University, graduating Phi Beta Kappa, and Harvard Law School on scholarships, topping his education off with a master's degree from New York University's School of Law. He was then a Ford Foundation Fellow at the University of Paris.

Despite his humble origins, he made a brilliant marriage. In 1966, he wed the daughter of oil and gas magnate and philanthropist Joseph Gruss. Her family was one of New York's richest, worth an estimated \$500 million when the patriarch died in 1993. The match hoisted Lipper onto the fast track.



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1969, after brief stints at law firm Fried, Frank, Harris, Shriver & Jacobson and the Dept. of Commerce, he joined Lehman, later becoming one of the firm's youngest managing partners, at 32. Says writer Michael Thomas, a former Lehman partner: "Ken has always had a knack for ingratiating himself. Of course, Evy's money didn't hurt him, either."

Cover Story

In the mid-1970s, Lipper moved to Salomon, where his legal knowhow and financial savvy made him a top dealmaker. One transaction involving Becton, Dickinson & Co. (BD), the Franklin Lakes (N.J.) medical-products maker, got him entangled with the SEC. In 1978, in what became known as the Midnight Raid, Lipper and several colleagues organized a telephone stock-buying blitz in an effort to get others to sell their BD stock at a premium, according to SEC documents. The blitz, according to the SEC, amounted to an undisclosed and illegal bid to take over the company. Lipper, along with Salomon, was found by a Federal judge in the Southern District of New York to have aided and abetted securities-law violations. The charge could have resulted in Lipper's being permanently barred from the securities industry. Lipper and Salomon, however, hammered out a settlement with the SEC, without admitting or denying liability, with a promise to obey the law in the future. The case was later terminated. In 1982, Lipper cashed out, with an estimated \$15 million, when Salomon went public.

Lipper was always fascinated by power. He once told Columbia

the suicide of a friend they had in common, J. Frederick Byers III. Byers and Walentas had been business partners. But the sources also say Lipper may have been using the situation in order to befriend Byers' widow, the daughter of Chief of Police William S. Paley, and her glitzy Park Avenue social circle, which included Byers' sister-in-law Amanda Burden and her then-husband, Carter, a businessman and Vanderbilt heir. Only since 1998 has Walentas been able to develop the part of Brooklyn situated down under the Manhattan Bridge overpass (DUMBO). Says Biderman: "Ken did what was in the city's best interest, in terms of trying to keep as many manufacturing jobs in Brooklyn as possible."

Toward the end of his City Hall stint, Lipper got wind that Oliver Stone was looking for a *Masters of the Universe* type to advise him on a movie to be called *Greed*. Initially, Lipper balked. But once he persuaded Stone to be somewhat more sympathetic to the Street, he joined in with gusto, penning some of the punchy dialogue for what became *Wall Street*. He coached Michael Douglas and Charlie Sheen in their roles. He even got to appear briefly toward the end of the film as a dealmaker in a boardroom scene. Later, he wrote the novelization of the screenplay. (A myth has somehow been perpetuated that Lipper wrote the book on which the film was based.)

Lipper fell in love with Hollywood, say friends. It was a busy time because he had just started Lipper & Co., primarily to manage his family's fortune. On weekends, he worked on a screenplay based loosely on his brief political career. The movie, *City Hall*, which Lipper also produced,



EVELYN AND KEN LIPPER IN 1996, AT THE OPENING OF HIS FILM CITY HALL

In 1986, he set up Lipper & Co., primarily to manage his family fortune. The following year, he broke into HOLLYWOOD as a consultant on Oliver Stone's *WALL STREET*. But by 2000, the strains of his bicoastal life finally sank his 34-year

marriage to EVELYN, a top developmental pediatrician and scion of New York's superrich GRUSS FAMILY. Part of the fortune of Evelyn and their four adult daughters was tied up in Lipper funds. >>>>

students that he had closely studied the literature about it, often rereading the stories of Hadrian, Antigone, and Richard III. Politics was a natural next step. In 1983, he became a deputy mayor, a position he held for three years. Lipper got kudos for his tough negotiating style against various Koch foes, such as the Port Authority of New York & New Jersey. But, says a former political ally, "one of the things you're not supposed to do in politics is remember personal problems with people. And people felt that Kenny did."

For example, in 1985, allegedly owing to a personal vendetta, Lipper thwarted real estate developer David Walentas' plans to develop the Brooklyn waterfront. The story of Lipper's aggressive maneuvering against Walentas was the subject of a riveting May, 1985, *New York* magazine cover called "On the Waterfront." Lipper, say sources, blamed Walentas for

starred Al Pacino, a boyhood friend, and John Cusack. It appeared in 1996 to tepid reviews. That didn't deter Lipper, who was already building a bicoastal life. Before long, he had opened an office in Los Angeles. He bought a house in Santa Monica and hung out in Aspen, Colo. He also became trustee of Robert Redford's Sundance Institute in Utah, which funds and promotes independent filmmakers. By the end of the decade, Lipper had more than a foothold in Hollywood. He had won Tinseltown's ultimate honor—his Oscar.

Back in New York, Lipper's glitzy Hollywood lifestyle did not appeal to his wife, say friends. Evelyn preferred a quieter existence. After the divorce, Lipper moved from their uptown five-story house to edgier downtown. He bought and began to redesign a multimillion-dollar West Village townhouse (bragging that his architect was the son



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JOHNNIE  WALKER

of I.M. Pei). Lipper quickly became a man-about-town, dating starlets and hanging out with "the Robert De-Niro crowd," according to one friend. "Here is a guy who had a midlife crisis of epic proportions," says a longtime family friend, adding that there is now an estrangement between Lipper and some family members.

Cover Story

Many people believe that Lipper's changed lifestyle, varied career, and multiple roles had a bearing on his hedge fund's demise. "He was an absentee landlord," says one investor. When the market continued to sour in 2001, with numerous companies teetering on the brink of bankruptcy, Strafacy and Visovsky—who had spent 13 years, almost their entire careers, working for Lipper—started buying the distressed securities of companies such as Global Crossing, Calpine, and Kmart, according to Race Rock's lawsuit. In particular, the two stocked up on convertible preferreds, which can be converted into common stock at a set price. The problem is that although those stocks act like junk bonds, paying high dividends, their holders get little or nothing if a company goes bankrupt. Meanwhile, Lipper's marketing materials stated that 70% of its securities were investment grade. Some investors estimate that more than half of the portfolio consisted of risky securities. Strafacy disagrees: "The issues were all appropriate and standard for a U.S. convertibles portfolio." Adds Biderman: "They may have been illiquid securities, but not speculative in that they were fly-by-night companies."

The Strafacy-Visovsky duo had been lowering credit quality to pump up the yield, according to Mark Friedman and Adam Stern, the managers called in to take over the portfolio after they left. What's more, the fund's stock hedges weren't nearly enough to offset losses on the bonds—especially as interest rates and stock prices fell in tandem, according to sources.

Lipper's flirtation with Hollywood included writing and producing *CITY HALL*, with boyhood pal Al Pacino and John Cusack (below). His crowning glory: The 1999 OSCAR for *The Last Days*, a Holocaust documentary that he produced with STEVEN SPIELBERG.



Says Charles Gradante, president and CEO of Hennessee Group LLC, a hedge-fund advisory and research firm: "Although [Lipper's fund was] classified as a hedge fund, Lipper often didn't hedge his convertible bond exposure."

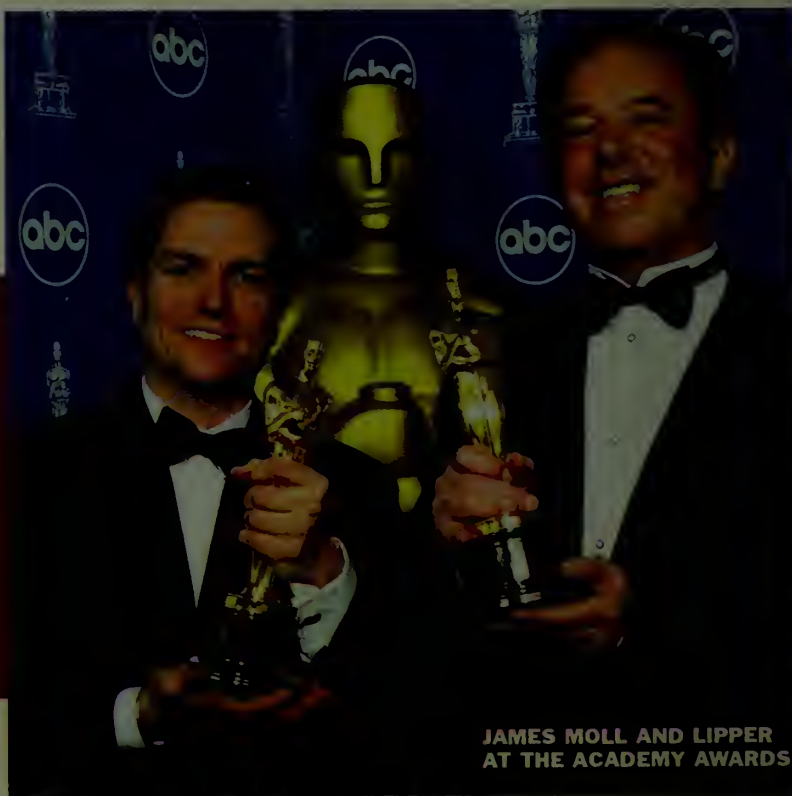
That wasn't all. Most fund managers use an independent third party to value—or "mark to market"—the seldom-traded securities every day. But the Lipper portfolio was rarely valued, and Strafacy and Visovsky did it on their own. "Few legit players do this themselves. It's almost a recipe for fraud," says the chairman of a respected money manager

who also runs a convertible arbitrage fund. Biderman, along with another executive vice-president, Stephen Finkel, sign off on the valuations, according to Strafacy. Biderman claims many hedge funds mark their securities internally.

Biderman and Lipper had met in the Koch Administration where Biderman was finance commissioner and later housing commissioner. Biderman was the closest to what the traders were doing, say insiders, but he had scant knowledge of convertible arbitrage. "It was the responsibility of Lipper, Biderman, and Finkel to have the fund officially audited. And Steve, especially, was a very intimate part of the process," say Strafacy. Biderman says the funds were officially audited. (Strafacy told *BusinessWeek* that he and Visovsky were starting their own convertible arbitrage fund.)

Lipper's friends say the events of the early part of the year threw Lipper into deep distress and that he dropped out of circulation. He was rarely seen at favorite haunts, such as the Council on Foreign Relations or the white-shoe Century Assn. "Kenny has been through emotional hell," says an old friend. In the late summer, however, Lipper resurfaced, lunching with Koch at Midtown Manhattan's San Pietro, known, as one critic puts it, for its "noisy power lunch." Though Koch denies it, some speculate Lipper had met with his old mentor for some career advice.

He may need it. Some investors want to remove him as liquidating trustee of Lipper & Co. "How can someone who has possibly committed fraud and almost certainly breached his



JAMES MOLL AND LIPPER
AT THE ACADEMY AWARDS

fiduciary duty act in the best interest of his investors?" asks one investor. Others are incensed that Lipper's distribution plan doesn't require him to give back any of the millions in performance fees, based on grossly inflated valuations, he collected for years. "He's paying himself for losing investors' money," says Mark Ressler, a lawyer for several investors. Other attorneys in the case say there's little doubt that investors will file damage suits against Lipper and possibly against PwC. Says PwC's Silber: "We see no reason why we should be sued."

Worse for Lipper is that his painstakingly crafted image may be irrevocably tarnished. As a broker in the movie *Wall Street* says, in a line Lipper might well have written: "We're all just one trade away from humility."

The Milwaukee-Madison Corridor: BUILDING FOR TOMORROW

*With its solid business foundation,
an economic region looks ahead.*

In the Milwaukee-Madison Corridor, civic and business leaders are engaged in plans and partnerships needed to build an economy that will prosper well into the 21st century. Their job will be made much easier by the fact that the foundation necessary for building such an economy is already in place.

There is no lack of enthusiasm for what lies ahead. In October, when the Metropolitan Milwaukee Association of Commerce unveiled its Blueprint for Economic Development, a new strategy for economic growth, it was hoped that as many as 800 people would attend. Instead, says Timothy R. Sheehy, president

of the MMAC, 1,500 people attended the Midwest Express Center. "Now," says Sheehy, "we're hard at work organizing business leadership around the Blueprint's agenda, and executing that agenda."

The spectrum of companies that flourished in the corridor area reflects the region's economic diversification. Northwestern Mutual, Harley Davidson, Oscar

Weyerhaeuser, Briggs & Stratton, Miller Brewing, and Johnson Controls are just a few of the many names that elicit almost instant recognition throughout the country, if not the world.

But it isn't only the successes of the past that hold promise for the region's economic aspirations. Despite the nation's economic downturn, new business start ups in the state totaled almost 22,000

in 2001, a six percent increase over 2000. And, according to state officials, new business start ups were up 15.6 percent for the first six months of 2002.

Confidence in the economic future has bred commitment, and there are few better examples of that than Wisconsin Energy Corporation. Based

in Milwaukee, the \$8.4 billion holding company is in the early stages of a 10-year, \$7 billion strategy to meet Wisconsin's growing energy needs. The willingness to earmark so much time and money is based firmly on conviction. "We looked at the prospects and we think they are excellent," says Chairman, President and CEO Richard A. Abdoo. By the company's reckoning, an increase in jobs,

households and population in Wisconsin will bring about a rapidly growing demand for electricity. Satisfying that demand, which is increasing at about three percent annually, will require planning and investment.

Wisconsin Energy is located in its historic Public Service Building, completed in 1906. Its utility subsidiaries serve one million electric customers and almost as many gas customers in Wisconsin.



Left: Madison is Wisconsin's state capital and the home of the University of Wisconsin's flagship campus. Center: The Milwaukee Art Museum features a striking addition, designed by Santiago Calatrava. Right: Opened in 1998, the Midwest Express Center is Milwaukee's new convention facility.

sin and Upper Michigan. Last April, subsidiary Wisconsin Electric-Wisconsin Gas became We Energies. The name change, says Abdoo, was part of Wisconsin Energy's determination to consolidate its image and its resources within the state. "We needed to get back in the game here at home," he says.

The company has done so in a very big way. In the short term, it has set about improving operating systems for the benefit of customers. Longer term, the strategic plan — known as Power the Future — would result in the largest construction project in the state's history. Among other things, it calls for \$3 billion to build 2,800 megawatts of new generation, \$1.3 billion to add capacity and reduce emissions at existing facilities, and \$2.7 billion to upgrade the distribution system.



Abdoo leaves no doubt about the need for Milwaukee and Madison to position themselves for the future, or his company's part in what's to come. "We view our role as absolutely critical," he says.

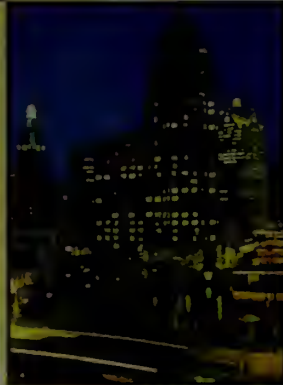
Yet another perspective on the future can be found at University Research Park, which is a conduit for the transfer of technology from the University of Wisconsin-Madison to the private sector. UW-Madison, the oldest and largest of The University of Wisconsin System's excellent four-year campuses, is second nationally in attracting research money. It includes among its faculty and alumni 17 Nobel Prize winners. The Madison campus, with an enrollment of 42,000, has a long history of research breakthroughs. One of the most recent examples was the stem cell research of James Thompson, Ph.D.

University Research Park has its 255-acre, 34-building campus in a residential area of Madison. A recent count indicated that more than 100 businesses employing some 3,000 people are located in the park, and approximately half of these enterprises

had a connection to the university. The campus is also home to the MG&E Innovation Center, a scientific incubator, which provides a flow of technology from UW-Madison to the marketplace. Founded in 1989, it has helped launch more than 50 companies.

The University Research Park is at the heart of an emerging technology corridor anchored by Milwaukee and Madison. In Dane County, which is home to Madison, high-tech jobs now account for eight percent of employment, but are expected to grow at a rate of about 10 percent annually. The area reportedly has more than 440 technology firms, with 25,000 employees and a payroll of more than \$2 billion.

All of this bodes well for the city of Madison, the capital of Wisconsin. Consistently ranked as one of America's "best" cities, Madison this past summer played host to the 2002 U.S. Conference of Mayors 70th Annual Meeting. The event was held at The Monona Terrace Community and Convention Center, which was built in 1997 along the water's edge of Lake Monona and is based on plans of architect Frank Lloyd Wright. Among several scheduled construction projects is a world-class downtown arts facility, Overture Center, made possible by a \$100-million gift from Madison businessman and philanthropist Jerry Frautschi. The Center is the work of architect Cesar Pelli.



Far left: Milwaukee's classic Public Service Building is the headquarters for We Energies and its parent company, Wisconsin Energy Corporation.

Left: Downtown Milwaukee is enjoying a construction boom.

But Madison isn't the only metropolitan area benefiting from new construction. Milwaukee, Wisconsin's largest city with 597,000 people, has a downtown that's humming. "We're bucking a national trend," says Julie Penman, commissioner of city development, referring to the preponderance of construction projects put on hold in many cities due to the economic slowdown. The Shops at Grand Avenue recently undertook a \$17 million renovation. Cathedral Place, a \$50 million development, will add 150,000 square feet of Class A office space and 36 condominium units, and a new investment of \$50 million in 875 East Wisconsin will add another



The Monona Terrace Community and Convention Center in Madison, built in 1997, is based on architectural designs first presented by Frank Lloyd Wright in the 1930s.

213,000 square feet of office space. As for living space, Kilbourn Tower Condominiums will add 59 luxury condos with prices ranging from \$500,000 to \$2 million.

Downtown housing has, in fact, been a priority in Milwaukee. More than 3,400 units have been built, with plans calling for 500 new units a year for the next 20 years. The push for such housing has much to do with making the city an attractive place for young people. "We're working as a region to attract and retain the best and brightest of Milwaukee," says Penman, who points out that the city is home to 64,000 college students.

Keeping young people close to home is also on the mind of the MMAC's Timothy Sheehy. The organization's 2,500 member companies employ 300,000 people, many in the manufacturing area, and they're going to need the best and the brightest. Like so many others, Sheehy is determined to see that the jobs and the people needed to fill them are there in the years ahead. "We're selling shares in the future of Milwaukee," he says.

The same could be said of Madison, and in both instances the people who live and work there are investing in the future. ©

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***So much cooperation,
it's no wonder the company is called***



We Energies wants to help build a strong economy in Wisconsin. One way to do that is to ensure that there's plenty of energy for businesses to grow and prosper in the state. So we worked with customers, businesses, labor unions and community groups to develop a plan for new power plants. The result? A plan that's as progressive as it is environmentally responsible. A plan that uses diverse fuels, renewable energy and conservation to increase the supply of reliable, affordable electricity while it actually lowers emissions. That's the power of working together. To learn more, visit we-energies.com

we energies
today, tomorrow, together.



COMMENTARY

By Aaron Bernstein

OPTIONS: MIDDLE MANAGERS WILL TAKE THE HIT

Executive stock options have become a flash point across Corporate America in the past year or so. The scandals at Enron Corp., WorldCom Inc., and elsewhere showed investors how imperial CEOs appeared to have cooked the books to pump their stock and cash in on lucrative options. The continuing stock market woes have tainted nonscandal executives, too, given how many profited by returns that have now evaporated.

The result has been tremendous pressure on companies to cut back on options. The battle will break out in the open during next spring's proxy season, when companies are likely to find it "a lot harder to get options plans [approved]," says Paula Todd, an executive-compensation expert at consultant Towers Perrin.

So, many companies are rushing to head off wrathful shareholders. Compensation consultants say the broad outlines of their plans have been laid out: Companies by and large intend to slash options awards—but mostly by reducing them for lower-ranking managers. Many top execs will stay on the gravy train, either by getting just as many options as before or by taking more pay in stock and cash bonuses. "Every single one of my clients is going to cut back on their option grants," says Michael S. Kesner, a partner in Deloitte & Touche LLP's executive-compensation unit. "The brunt of it will fall on middle managers, I hate to say. Now, most of what's spent will go to the top people."

Companies that do so will only harm shareholders all the more. Al-

ready, most top execs can't justify the huge sums they have taken. To grab even more only demonstrates again how little control most boards exercise over CEOs, who basically set their own salaries. Shareholders

would be better served if companies cut outsize grants at the top and maintained them for employees down the ranks. The more modest option rewards middle managers get—which research shows lift motivation and productivity—are more likely to fulfill the original idea of aligning the interests of employees and stockholders.

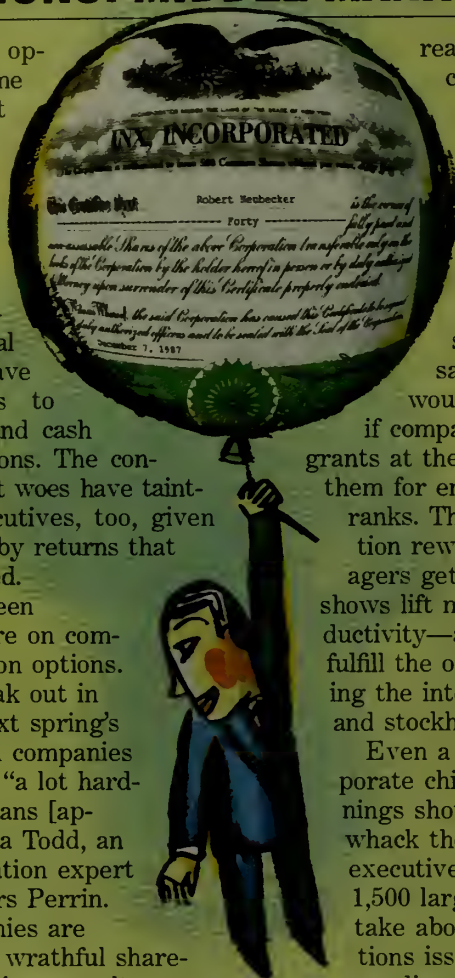
Even a cursory look at corporate chieftains' option winnings shows how far out of whack they are. The top five executive officers of the 1,500 largest U.S. companies take about 30% of all options issued every year, according to an analysis of

Securities & Exchange Commission filings done for an upcoming book co-authored by this writer. From 1992 to the peak of the market in 2000,

this corporate elite saw a 1,000% increase in the paper value of their unexercised options, to a collective \$80 billion. Over that same period, the Standard & Poor's 500-stock in-

dex rose 350%, which means execs gained nearly three times as much as the shareholders they serve.

Swapping options for stock or bonuses won't solve the problem, either. Many companies plan to use them to ensure that the top guys lose nothing, says June Anne Burke, who heads the global stock plan group in the U.S. at Mercer Human Resource Consulting LLC. This ignores the real issue, which is that executives take too much from shareholders. For example, incoming WorldCom CEO Michael Capellas is due severance of some \$14 million from his old post at Hewlett-Packard Co., plus millions more at his new job. Similarly, Tyco International Ltd.'s new CEO, Edward



THE SQUEEZE TO COME

More than 50% of large companies say they'll do one or more of the following if new rules require stock options to be expensed:

- ▶ Reduce the number of employees eligible to receive options
- ▶ Limit the total number of options granted
- ▶ Switch to other incentives, such as stock or cash bonuses

Data: Deloitte & Touche

D. Breen, got stock and options that could be worth more than \$50 million

Targeting only lower-level managers for options cutbacks "runs counter to the concern that huge options [packages] for key executives motivate them to make decisions in their own interests, not in the interests of the company," says Burke. Investors should take heed as the proxies start to roll in with revamped compensation plans.

Senior Writer Bernstein co-authored with Rutgers University professors Joseph Blasi and Douglas Kruse In The Company Of Owners: The Truth About Stock Options (And Why Every Employee Should Have Them), to be published in January by Basic Books.



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EVENT PLANNING
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THE WALL STREET JOURNAL

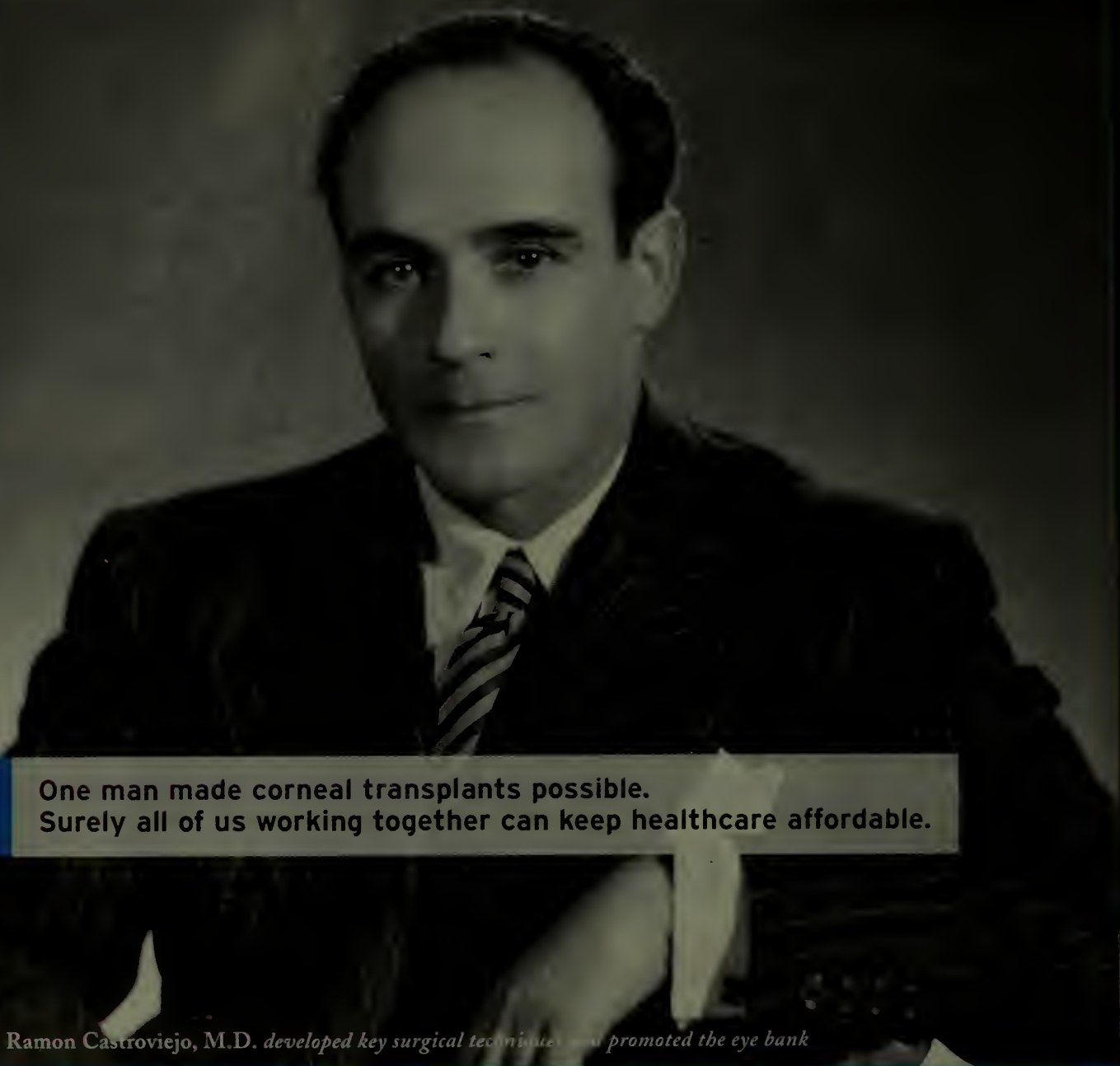
Tech Data



PUBLICIS

Proceeds from the event will be donated to the
National Center for Missing and Exploited Children (NCMEC).

NATIONAL
CENTER FOR
MISSING &
EXPLOITED
CHILDREN

A black and white portrait of a middle-aged man with dark hair, wearing a dark suit, white shirt, and a striped tie. He is looking directly at the camera with a slight smile. The background is a soft, out-of-focus grey.

**One man made corneal transplants possible.
Surely all of us working together can keep healthcare affordable.**

Ramon Castroviejo, M.D. developed key surgical techniques and promoted the eye bank

Insurers. Drug companies. Hospitals. Physicians. Lawmakers. Employers. Consumers. We all need to work together to keep healthcare affordable. And right now, the BlueCross BlueShield system is leading the way.

We're funding research to uncover the real drivers of healthcare costs and we'll share what we learn. We've teamed up with the Washington Business Group on Health to launch the Institute for Health Care Costs and Solutions. We're working with others to support legislation so that safe, effective, lower-cost generic drugs get to market when they should.

Because the Blues collectively insure one out of four Americans, we know the size of the challenge. And we know that together, all of us can keep healthcare affordable.

To receive a copy of our research on the drivers of healthcare costs log onto www.bcbs.com.



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Investor

MAKING LIFE RICHER

NOVEMBER 9, 2003



Our Holiday Gift Guide

Camcorders **126** Foods **128**

Vines **128** Spa Services **129** Books **130**

Give A Child With A Cleft A Second Chance At Life.



Today, millions of children in developing countries are suffering with cleft lip and palate. Condemned to a lifetime of malnutrition, shame and isolation.

The good news is that virtually all of these children can be helped and their clefts repaired. That is the mission of The Smile Train. We empower local surgeons in developing countries to provide this life-changing free cleft surgery which takes as little as 45 minutes and costs as little as \$250. It gives desperate children not just a new smile — but a new life.

The Smile Train will deliver free cleft surgery to more than 35,000 children this year, all over the world. From Asia to Africa, from South America to Russia. The Smile Train helps children who have no place else to turn.

But we can't do it without your help. Send us a donation today and we'll use it to give someone a second chance at life.

YES, I want to give a child a second chance at life.

- ☐ \$250 Provides cleft lip surgery for one child.
- ☐ \$125 Covers half the cost of one surgery.
- ☐ \$ 50 Provides medications for one surgery.
- ☐ \$ 25 Provides sutures for one surgery.
- ☐ \$ We'll gratefully accept donations of any amount.

Name _____

Address _____

City _____ State _____ Zip _____

Telephone _____

eMail _____

Send this coupon with your donation to:
The Smile Train, 245 Fifth Avenue, Suite 220L New York, NY 10016

100% of your donation goes towards programs —
0% goes towards overhead.



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Changing The World One Smile At A Time.

1-877-KID-SMILE www.smiletrain.org

*Our Board of Trustees pays for all non-program expenses, such as overhead, administration and fundraising. The Smile Train is a 501 (c)(3) nonprofit recognized by the IRS, and all donations to The Smile Train are tax-deductible in accordance with IRS regulations. © 2002 The Smile Train.

Dividends

tips,
tidbits &
more

EDITED BY
TODDI GUTNER

THE STAT

1,073

AVERAGE amount
consumers anticipate
spending on gifts this holiday
season, up \$29 from 2001.

Data: American Express

DOGS

BEST IN SHOW?

These "dogs" may
pay off nicely

Some investors
buy the "**Dogs of
the Dow**"—the
stocks with the
10 highest
dividend yields
among the 30
Dow Jones
industrials—at

the end because they tend to
outperform the next year's best
performers. The 12/31/01 Dogs
gained **10.3%** in price year-to-date
through Nov. 22. The S&P 500
index sank **18.7%**. Had the
Dogs been chosen Nov.
General Electric and
Honeywell would replace
Mobil and Merck; Philip
Morris would bump Eastman
Kodak from the top spot.

PANYP	YIELD
JP MORRIS	6.90%
MORGAN CHASE	5.44%
GENERAL MOTORS	5.32%
EASTMAN KODAK	4.83%
TELECOMMUNICATIONS	3.92%

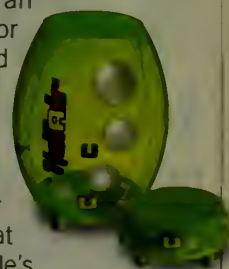
Data: www.dogsofthedow.com



AUDIO

HOT AIR, COOL SOUND

Tired of headphones? **Blow up** the sound from your portable MP3 or CD player with **inflatable speakers**. They run off an AC adapter or batteries and deflate to fit a jacket pocket or laptop case. Get them for **\$50** a pair at Bloomingdale's, Discovery Channel stores, and ellula.com. Smaller ones that look like Budweiser cans are \$29 at budshop.com.



TRAVEL

WINE AND WHEELS

Here's a little yearend getaway. Spend two nights each at the Fairmont Hotel in **San Francisco** and the Sonoma Mission Inn & Spa in the **Sonoma Valley** and you also get the use of a new **Porsche**. At \$7,990, the package includes champagne, spa treatments or golf, a picnic lunch, and valet parking. The deal's good only through Dec. 31.



PAYING FOR COLLEGE

A Time to Dump

SURE, YOU DID THE RIGHT THING by setting up **529 college savings plans** for the kids. How could you have known your capital was about to get mauled by the bear market? At least there's a chance for some tax savings to salve those financial wounds and, in effect, start over.

If what's left in the account is less than the total invested, you can withdraw all of it. **No federal taxes or penalties are due** because there are no earnings. You can't take a capital loss, but the Internal Revenue Service will allow a miscellaneous itemized deduction. Of course, that won't do much unless all such deductions add up to more than 2% of your adjusted gross income. And if you're taking a loss, better to wait 61 days before opening a new 529—otherwise the IRS might consider it a rollover.

For those unhappy with their initial 529 choice, this could be the best opportunity to change. Of course, a write-off isn't as good as a profit. But, hey, this is the school of hard knocks.

Carol Marie Cropper

You Always Wanted to Direct

New, tiny digital camcorders make it easier than ever.

BY LARRY ARMSTRONG

THE MOST amazing thing about today's camcorders is just how tiny they've become. You can comfortably shoot all day long with a lightweight model, and some are small enough that they fit inside a coat or pants pocket. You'll be amazed how much more you'll use a camcorder that you can take anywhere, instead of one that you take out of the closet only for special occasions. And, because they're digital, you can easily transfer everything you bag on video to your computer and edit your work into a mini-movie.

Whether you're a first-time buyer or in the market for a newer model, here's what to look for while you're shopping. First off, forget about the analog camcorders. Sure, they're temptingly cheap, with prices starting around \$200. But they're big and bulky, and your home movies will have the slightly fuzzy, smeary look of a rental video.

Video from a digital camcorder is twice as good: The images will be almost as sharp as those in a DVD movie. And editing analog VHS-C and Hi8 tapes is so tedious that most people don't take the trouble. You have to do it on a VCR or buy a special converter box or video card to get your movies into your computer. Either way, you sacrifice

IN THE PALM OF YOUR HAND:

The Canon Elura 40MC (left), sells for \$900, the Panasonic PV-DC252 costs \$700, and the Sony DCR-IP55 goes for \$1,500.



even more picture and so quality in the process.

Digital camcorders start around \$450 and can run up to \$2,000 or more for some consumer models. It's a good idea to do some homework before you head off to the mall. Figure out what features are important to you, and how much you're willing

pay in order to get them. That makes it easier to zero in on your best options among the overwhelming number of models you'll find in the store.

■ **DISPLAY** All digital camcorders now come equipped with an LCD screen that ranges in size from 2 inches to 3.5 inches, measured diagonally. It makes setting up shots

and viewing your results easier.

Expect to pay about \$50 for each additional half-inch of screen size. With the smallest camcorders, you won't have

a choice: A bigger screen just won't fit the chassis. Canon's \$900 Elura 40MC, for instance, only comes in a 2-in. version.

No matter what the screen's size, make sure you look at the screen in bright sunlight to check that the picture doesn't fade.

■ **SIZE AND WEIGHT** Ultra-compact camcorders cost about \$100 more than the same maker's conventional ones.

More than Just Movies

The best thing about DVDs are: the extras the studios include. This year's family favorites for TV and computer fun include:



Spirit: Stallion of the Cimarron Make a mini-Spirit movie with your photos and narration, along with the film's characters and music.



Lilo & Stitch Learn to hula; create your own Stitch-like alien. Funny trailers put Stitch in Disney flicks.



How the Grinch Stole Christmas Put the Grinch into your family photos. Try the Who-liday dessert recipes.

Sony's Digital8 camcorders, from \$500 to \$900, let you record digital signals on the bigger, older, and cheaper 8mm and Hi8 analog tapes. The only reason to buy a Digital8 camcorder, however, is if you already have a library of analog 8mm or Hi8 tapes. It will play them and even convert them to digital should you want to store or edit them on your computer. (If your Hi8 camcorder still works, you can hook it up with cables to any digital camcorder with the same result.) The risk, many experts say, is that Digital8 will become an orphan format that will

leave you with an even bigger library of obsolete tapes the next time you're in the market for a new camcorder.

Sony's MicroMV camcorders, starting at \$1,200, are the smallest on the market. The tapes are the size of a matchbox,

about a third the size of MiniDV tapes. The tape

cassette also has a tiny memory chip that stores a thumbnail photo of each new video segment that you record. That makes it easier to go back and search for specific scenes when you're showing the tape to your friends. The problem with the MicroMV camcorders, though, is that they're so small that they can be hard to use, especially if you have large hands.

The latest model, the \$1,500 DCR-IP55, even has a foldaway pistol grip reminiscent of 8mm film cameras to make it easier to hold.

Once you get your camera back home and start shooting, don't just stack all of the tapes on a dusty shelf, waiting for a captive audience over the next important holiday. These days, editing digital videos in your computer isn't the hassle that it used to be. Compile the highlights of your birthday party or vacation into an easy-to-watch music video that you can burn onto a CD or DVD or zip off to the grandparents in an e-mail. That way, no one has to sit through your 10-hour day at Disneyland. But they'll love seeing those few precious moments. ■



with the same or similar features. They're lighter, so your arm won't give out in the middle of a shoot.

At just over 1 lb., Panasonic's PV-DC252, a \$700 midrange choice, is a quarter-pound lighter and 2.5 in. shorter than its \$600 PV-DC202, for example.

BATTERY LIFE The standard-issue camcorder battery will give you only a couple of hours before it needs a charge. Go ahead and spend an extra \$50 to \$125 for a long-life spare that will go up to 8 or 10 hours. You'll be glad you did.

SNAPSHOT CAPABILITY Step-up models, for about \$100 more, have a removable memory card and, sometimes, a built-in flash for taking still pictures. Look for a USB port to transfer the snapshots to your computer. Don't expect high-quality photos. Even the so-called megapixel camcorders don't produce images as sharp as a digital still camera. If you intend to use the camcorder for snapshots, don't pay extra for a 2-million pixel sensor: It won't noticeably improve the quality of images recorded in video mode.

FEW OTHER HINTS

A microphone on the side of the camcorder usually produces better sound than one situated on the top. For the best audio quality, shell out an extra \$50 to \$100 for an external microphone—and make sure you have a place to plug it in. Ignore all the hype about the incredible zoom capability of some camcorders—claims ranging as high as 100X zoom. Most of the magnification is the result of a digital technique that blows up the center of the picture with increasingly grainy results. Optical zoom, which counts when you want a close-up, is what camcorder lenses are generally 10X or 18X on older models.

Most digital camcorders that you'll find use a tape format called MiniDV. It's the smaller size that makes the digital models smaller than their analog counterparts. There are two other formats, Digital8 and iV, but only MiniDV makes them.



(Other) Seasons' Greetings

With these treats, anticipation is half the fun. **BY ED LEVINE**

TIS THE SEASON TO BE jolly, but 'tis not the season for blood peaches, chocolate-covered blackberries, and Copper River salmon. Still, you can entice your friends and loved ones now with a certificate that offers the promise of these edible gifts, then enjoy their delight when a shipment of the real thing arrives in the mail months later. Call them delayed-gratification gifts.

Berry bushes may be bare these days, but come next summer, they'll be laden with ripe fruit. Bissinger, a 139-year-

old St. Louis confectioner, sells luscious dark- or milk-**chocolate-covered raspberries** and **blackberries** only when they are the sweetest and ripest: July for raspberries, September for blackberries. A one-pound box of either costs \$34 and can be ordered at bissingers.com or by calling 800 325-8881.

Vine-ripened tomatoes are another summer treasure, and they taste better than those grown in a greenhouse. Lee, a former professional singer, lives in the Smokey Mountain

North Carolina. Order a \$14.95 box of 10 Smokey Mountain beefsteaks plus a half-pint of red grape tomatoes now, and your gift recipient will feel lucky to receive the package in July (luckystomatoes.com; 888 963-2100).

Throughout the summer, Ron Mansfield of Gold Farm in Placerville, Calif. (530 626-6521), harvests some of the best stone fruit I have ever tasted. His nectarines and cherries are wonderful, but his pièce de résistance may be the **Indian blood peaches** picked in mid-September. Their dark red, almost purple flesh is sweeter than candy and juicier than most oranges (\$60 for a box of 12 with shipping).

Forget those wrinkly, intensely sweet dried dates with

ICE WINE:

A Winter Crop to Wow The Palate



For winemakers in northern latitudes, it has become an annual ritual: Wait for below-freezing temperatures, then race to hand-harvest ice-glazed riesling, vidal, or seyval blanc grapes to make into intensely flavored but not overly sweet ice wines.

The 18th century German *Eiswein* tradition came to North America only in the past decade, courtesy of Inniskillin, a vintner on Ontario's Niagara Peninsula. Given the risks of leaving a



crop on the vines into winter, ice wines are pricey. A top import such as Robert Weil Kiedricher Gräfenberg costs \$258 for a standard size half-bottle. Inniskillin's entry-level riesling runs \$85.

Fortunately, there's an expanding array of brands. None is cheap, but retailers have been surprised at how even younger drinkers are willing to splurge on ice wines.

Inniskillin is both



the pioneer and producer in North America. Its oak-aged vidal (\$85) offers a spicy, aromatic flavor. Two unusual offerings are Sparkling Ice (\$95), which makes up wonderfully for winter day desserts, and Cabernet Franc, a rare red ice wine. Other top ice wines from the Niagara region include Koehnmann, Henry O'Neil, and Château de Charmes.



grew up with: Eating **fresh dates** is another experience altogether. From the prime date-growing country of the high desert in Southern California, Bautista Organic Date Ranch ships dates fresh off the trees in October (760 396-2337; \$8.55 for two pounds).

For the serious cook, fresh **morels**, a kind of mushroomlike fungi, are like manna from heaven. Amy LaFarge's troops comb the fertile soil of the Yukon and the Pacific Northwest starting in late April, looking for the morels that will transform a simple plate of pasta or a roast chicken into some-

g special. One pound of morels that will arrive in May is \$12 to \$16 from auxdelices.com or 888 547-5471.

beyond fruit and vegetables, seafood caught and delivered season makes for great delayed-gratification gifts now. You can buy farm-raised salmon year-round, but it doesn't compare in flavor, texture, or appearance to the wild variety, especially **the salmon of Alaska's Copper River**. Every spring (usually in late May or early June), more than a million salmon return from the sea and, fortified with rich stores and bulging muscles, make their way up the Copper River to spawn. SeaBear Smokehouse (seabear.com; 800 FISH) sends out packages of eight fresh filets (\$67.90 shipping) that arrive within 48 hours of the fish being out of the water.

Finally, few people who head to Miami in the winter resist the siren call of Joe's Stone Crab restaurant. But there's a way to enjoy those same sweet morsels of chilled, cooked crab in mustard sauce without heading to Florida. Moore's Stone Crab (888 968-CRAB), a family-run endeavor in Long Key, Fla., ships three sizes of **stone crab claws**. And because the stone crab season goes from December to May, it's a gift you can present that will arrive well into the spring (\$102 for dinner for two with shipping).

When you send these foods, warn the recipient to keep them out of the reach of children, in-laws, and dogs. Otherwise, the gift quickly becomes an empty box, which is no less the idea of a seasonal treat. ■

Columbia's Napa Valley also has excellent producers, including Gehring, Jackson-Triggs, Hill, and Lang. With brilliant aging and standout producers like Gehring's (the Centigrade is the purest at which the grapes are made). In Napa State's Napa Valley, vintners are offering reasonably priced ice wines and a 1998 semillon. The Crest label at



\$28. And Minnesota's Alexis Baily Vineyard recently released a highly regarded seyval at \$22.

Considering the production difficulties and expenses, ice wine isn't likely to become a mass-market item. Indeed, the warm winters that have forced vintners to wait longer to harvest could induce some to cut back. "Some wineries are saying: 'Nuts to this,'" says winemaker Walter Gehring. "Enjoy it while we make it."

Gerry Khermouch

Spas: Getting the Lingo Right

To select the right spa gift, you may need some tutoring in spa-speak:

Facials In a basic one-hour facial (\$50 to \$100), the face is cleansed, exfoliated (stripped of dead skin cells), steamed, toned, and moisturized. Add-ons include collagen, meant to firm the skin, or vitamin C to help diminish scars and fine lines. Other types add oxygen or a combination of vitamins.



Massages Most common is the relaxing Swedish type, in which a masseuse works your muscles with oils and lotions. For those who prefer to stay clothed, there's shiatsu to unblock energy points in the body. A more aggressive sports massage might be a better bet for a sore athlete. Exotic varieties include watsu, done in a pool, or reflexology, where a therapist applies pressure to the soles of the feet. If you want to relax, skip this; it can hurt.

Body Wraps Here, the whole body gets wrapped or immersed in a beneficial substance. Seaweed paste can provide a pick-me-up; mud draws out impurities; green tea is meant to be calming, while eucalyptus is said to energize.

If choosing services sounds daunting, buy a gift certificate for a dollar amount and let the recipient do the picking. You can also go to spafinder.com, which offers certificates accepted by 700 spas.

Anne Field

Deck the Coffee Tables

These glossy books will bring joy throughout the year. **BY THANE PETERSON**

THE BEST coffee-table books are like a bag of movie popcorn: You start thinking you'll just take a quick taste and before you know it you've been eating for two hours.

That's certainly the case with **Jarvis Bond: The Legacy** (Abrams, \$49.95), a book chock-full of interviews, photos, and 007 memorabilia. Published to coincide with the 50th anniversary of Bond's creation by author Ian Fleming—and to hype the opening of *Die Another Day*, a Bond flick No. 22—it's a fun nostalgia trip with numerous anecdotes about the Bond movies. Paul McCartney, for instance, was such a big fan that he ran out and bought an Aston Martin DB5 after seeing Bond drive the car in the 1964 film, *Goldfinger*.

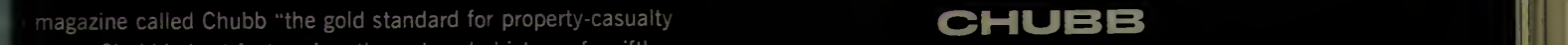
The Irish: A Photohistory (Thames & Hudson, \$35) covers the harsh century that started with the famine of the 1840s—a period during which Ireland's population fell more than a third, to just five million. The historical photographs start with beautiful hand-tinted daguerreotype portraits



A person is sitting on a balcony, looking out at a sprawling city and distant mountains under a cloudy sky. The person's back is to the camera, and they are wearing a dark jacket. On the balcony railing, there are some framed pictures and a small plant. The text "Life is too short to worry about your insurance." is overlaid on the image.

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from the mid-1800s, are fascinating and often moving. The images of lynchings, slavery, and other injustices in **Freedom: A Photographic History of the African American Struggle** (Phaidon, \$59.95) also are disturbing. The book ends in the era of Oprah and Colin Powell, illustrating sharply how much has changed.

Another of the many fine photo histories is **Explorations: Great Moments of Discovery From the Royal Geographical Society** (Artisan, \$35). It documents British exploration over the past 150 years with text by such luminaries as Sir Edmund Hillary and Richard Leakey. What makes this book a keeper are the more than 300 photos of an astonishing variety of places and native peoples as they are first being visited by outsiders. **Dorothea Lange: The Heart and Mind of a Photographer** (Bulfinch Press, \$75) is a crisp overview of the career of the great photographer who is noted for documenting the ravages of poverty. *Migrant Mother*, her most famous image, was shot in 1936, but she continued to take socially conscious photos in the U.S. and developing world until her death in 1965.

Afghanistan: The Land that Was (Abrams, \$45) shows why so many travelers fell in love with that nation before it was ravaged by war, Soviet occupation, and the repressive Taliban government. Photographers Roland and Sabrina Michaud roamed Afghanistan from 1964 to 1978, taking beautiful photos of the nation's mountainous terrain and tribal peoples.

A good gift for budding artists is **Art: The World of Art, from Aboriginal to American Pop, Renaissance Masters to Postmodernism** (Watson-Guipill, \$50). It includes a breezy overview of art history, as well as an A-to-Z listing of nearly 400 artists with a reproduction of a key work of each.

Any art lover who hasn't seen the Sistine Chapel since restoration of the frescoes there will be amazed by the reds, greens, and ultramarine blues in **Michelangelo: Frescoes of the Sistine Chapel** (Abrams, \$39.95). The pressiveness of the faces and beauty of the clothing tapestry in these Biblical scenes are breathtaking. **Pieter Breugel** (Abrams, \$49.95) incorporates the latest scholarship on the great Renaissance painter. The horrific image paintings such as *The Triumph of Death* seem almost temporary in the way they anticipate the horrors of modern warfare.

The Architecture of Philip Johnson (Bulfinch Press, \$85) shows how far the great architect ranged beyond skyscrapers. Whether it's his famous Glass House in Canaan, Conn., the soaring Cathedral in Garden Grove, Calif., or museums such as the Sheldon Memorial Art Gallery in Lincoln, Neb., his designs are prising and innovative.

An excellent gift for theater aficionados is Playbill's **At This Theatre: Years of Broadway Shows, Series & Stars** (Applause, \$19.95), which provides anecdotal stories of all the major Broadway theaters. This edition dates the original 1984 version to include the 1990s renaissance when many theaters were restored. For the wine lover on your list, try **Oz Clarke's New Wine Atlas** (Harcourt, \$60), which analyzes the world's major wine-growing areas. It's invaluable in deciphering wine labels.

A macho nostalgia trip to rival the Bond book is **Harley-Davidson Century** (MBI Publishing, \$50), a photo-filled appreciation of Harley motorcycles and the companies that makes them. There's a lot of business history, and Harley mystique is heavily analyzed, too. There's even an excerpt from Hunter S. Thompson's famous 1967 book about the Hell's Angels. As with most coffee-table books, give it to the right person and the recipient will be in hog heaven.



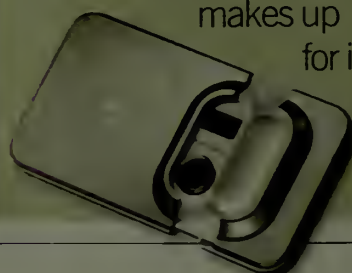
GIFTS FOR EVERY POCKET

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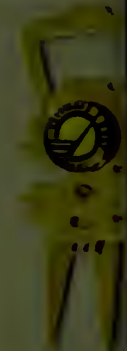
Know someone who would like a Mini-Me? For a mere \$7,500, you can give that special person on your gift list his or her likeness in a **six-inch-tall polyurethane action-figure**—courtesy of Neiman Marcus.



Logitech's credit-card-size Pocket Digital snaps open to reveal a lens and viewfinder. Hook up the \$130 camera to a PC to upload snapshots. No flash, no display, but the cool factor makes up for it.

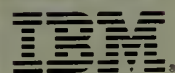


The Ultimate Golf Tool (\$15-\$25) from Tee-It Up Sports is a cleat remover, groove cleaner, divot mender, screwdriver, knife, can and bottle opener, club rest, and ball marker, all in one. Available at teeitupsports.com.





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This Year, Don't Just Give, Give Smart

Here are some tips for making donations go further.

BY CAROL MARIE CROPPER

Your stocks are back to 1998 levels, your spouse just got laid off, and now you're starting to worry about the value of your house. None of this means your favorite charities have downsized their yearend requests. With foundations scaling back and with corporate profits—and therefore corporate giving—in question, philanthropy may need you more than ever. The trick is to make your scarcer dollars do the most good.

After rising 7.4% a year during the '90s, charitable giving went up a measly 0.5% last year. Leo Arnoult, chairman of the American Association of Fundraising Counsel, which tracks giving, says this year's best hope is for individual givers to compensate for any declines in foundation and corporate largesse.

One trick to make parting with your dollars less painful is to turn on its head the age-old advice about donating appreciated stock. Instead, dump your losers, and send the cash. That way, you get a deduc-

tion for both the capital loss and the charitable contribution. Or, double the impact of your greenbacks by focusing on charities that qualify for a match from your employer or from a philanthropist or government agency offering a challenge grant. Hartford Financial Services Group, for instance, matches employee gifts to educational institutions dollar for dollar, up to a \$2,000 maximum. New York's Metropolitan Opera has a well-heeled donor willing to match up to \$1 million for a program to preserve the opera's aging radio broadcast tapes.

STRAIGHT DOPE

Make sure any charity you support is a good steward. See if the Internal Revenue Service's Web site (www.irs.gov/charities/index.html) lists it as a tax-exempt 501(c)(3). Guidestar.org lets you look at the 990 reports that charities



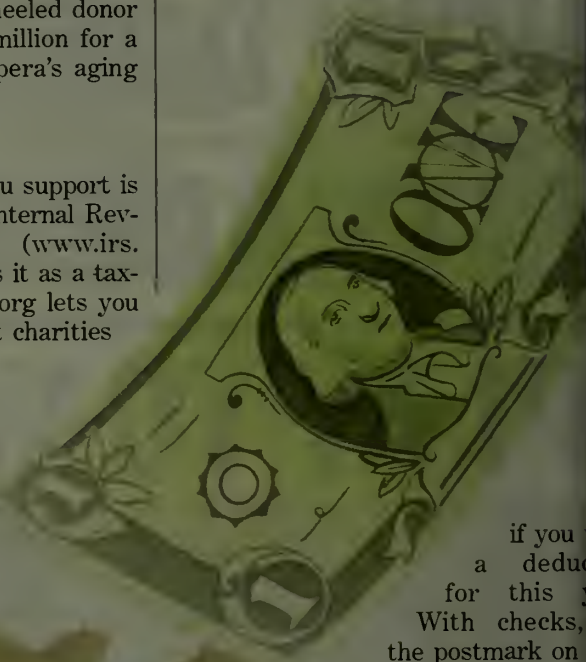
Make sure any group you support is a good steward. Guidestar.org can tell you just how funds are spent, and several other Web sites evaluate charities

file each year with the IRS—detailing how much money they raised and what it cost them. Avoid charities that gobble up more than 25% of the money given with fund-raising and administration costs, says Chas Miller, president of Forward Foundations, which advises

wealthy donors. Sites such as charitynavigator.org, charitywatch.org, and give.org offer charity evaluations (ENR Nov. 11).

There are also sophisticated giving vehicles that let you maximize charitable efforts. A donor-advised fund set up through a community foundation or investment firm, will let you take a tax write-off this year but dole out cash over time, says Frank Minarik, president of Planned Giving Services, a Seattle gift-planning consulting firm. It comes with a more generous tax deduction than big donors would get by establishing a private foundation. Alternatively, you could name a charity as the beneficiary of your individual retirement account, should you have any of it when you die. A family member who got it instead would have to pay taxes on the gains inside.

Finally, keep the deadlines in mind



if you want a deduction for this year. With checks, the postmark on the envelope that comes with the check says Anita Williams, a wealth adviser at J.P. Morgan Private Bank. For credit-card contributions, the gift takes effect when it is charged to your card.

Stocks can be stickier. If held by a broker, the giving date is the day the shares enter the charity's account. When you're transferring a stock certificate, the important date is when it is registered to the charity. Executives planning to donate restricted stock should allow a couple of weeks to complete the process.

For many, parting with the money will be especially wrenching this year. But abandoning an old friend in a recession would be difficult, too.

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THE MERC IS FAR FROM A HOT COMMODITY

BY ROBERT BARKER rb@businessweek.com

YOU KNOW ALL THOSE Chicago traders, the ones who scream and body slam like a pack of overage punk rockers? Picture this: They're hoping you'll help finance their mosh pit.

The particular pit in question is the Chicago Mercantile Exchange. The nation's busiest arena for buying and selling futures contracts, the Merc is in the final stages of a long-awaited plan to go public. Aimed for the first week of December, the initial public offering is set to raise an estimated \$154 million (table) in exchange for about 20% of the Merc's parent, Chicago Mercantile Exchange Holdings.

Chief Executive James McNulty and other Merc execs are keeping mum ahead of the deal. Yet the Merc's securities filings spell out how, in some ways, business has never been better. Trading volume this year through September soared 40%, as investors kept rushing to bet on—or hedge against—moves in interest rates, currencies, stock indexes, and, even still, such original Merc commodities as butter. All told, revenue from executing and clearing trades, plus more from such ancillary sources as sales of market data to brokerage firms, jumped 18% in the nine months ended Sept. 30.

That's all to the good. However, prospective investors also will want to examine some less alluring aspects of the deal. What's particularly striking about the Merc is the gap between the flood of money rushing through it and how little it siphons off. Last year, for example, \$294 trillion—that's trillion, with a T—in contracts changed hands at the Merc. Yet it netted just \$68 million on revenue of \$387 million. So, despite its big hat, the Merc in fact owns few cattle.

Perhaps more immediately alarming is a recent erosion of profitability. That's because the Merc has been discounting. Through the Merc's first nine months last year, it was able to

collect an average of 71.7¢ per contract traded. So far this year, the average has sunk to 63.2¢ a contract. If that level persists through the fourth quarter, the Merc's average rate per contract will be lower than it has been since 1998. Nor is that the only weak spot as distress in the broader financial-services business bears down. Through



September of this year, the number of brokers' computer screens showing Merc data shrank by 10,000, to 180,000. As you might expect, all of this has put a squeeze on operating margins, which shrank by two percentage points, to 30%, through September.

Much of the Merc's business is cyclical, and margins may one day expand again. But an worry that figures to persist for outside investors is the ant conflict of interest facing 17 of the Merc's 20 directors. This is a group that also represents Merc member firms—traders and brokers who own the right to scream, and otherwise conduct business in the pit. As Merc members, these 17 directors will want to keep a lid on trade execution and clearing fees, which are the Merc's greatest source of revenue and profit. "Consequently," the Merc's filing says, "members may advocate that we enhance and protect clearing and trading opportunities and the value of trading privileges over their economic interest in us."

These are not propitious days for bringing IPOs to market, a fact that might make some investors see shares in the Merc as an out-of-season bargain. Yet at an indicated \$32.50 a share, the Merc is not coming to market cheap. That would give the Merc a total market value of more than \$5 billion, or about 14 times the past 12 months' net. Just the same, don't bet against this deal finding a way to get done. CEO McNulty has a potent incentive to complete the IPO: He holds enough stock options that if he were to cash out at \$32.50 a share, he would come away with \$31 million, plus \$1 million more a year later. So forget the mosh pit. For outside investors, the Merc looks like a money pit.

THE PIT: If the IPO goes through, CEO McNulty's stock options would be worth \$39 million.

HERE COMES THE MERC

Key details of the Chicago Mercantile Exchange's upcoming IPO

Ticker Symbol	CME*
Lead underwriter	Morgan Stanley
Estimated value of the IPO	\$154 million
Indicated price	\$32.50 per share
Tangible book value, pre-IPO	\$10.40 per share
Web site	www.cme.com
*Proposed	Data: Company reports

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BY GENE MARCIAL

A Low Ceiling at NVR?

Whether or not housing is a bubble ready to burst, some investors are bailing out. Housing is "decelerating," says Ivy Zelman of Credit Suisse First Boston, who has downgraded to "neutral" the shares of NVR, one of the top U.S. homebuilders. Credit Suisse has done banking for NVR. Although Zelman doesn't expect a housing collapse, she doesn't see the sector outperforming the market in the coming year.

A number of hedge-fund managers are more bearish: They expect NVR, which rocketed from 162 a share a year ago to 336 on Nov. 26, to plunge to 135 in 18 months. On May 2, it hit 391. One short-seller who prefers not to be identified says that NVR's price-earnings ratio of 9.6 is higher than the 5 to 7 of its peers. The stock's rise has been helped by NVR's buyback at high prices. With only 7.2 million shares outstanding, the buybacks helped drive up the price, he says. That also let insiders sell high, he adds.

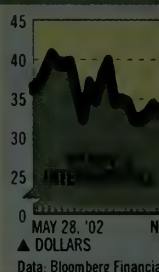
In the nine months ended Sept. 30, 2002, NVR bought back 1 million shares at an average of 296. In that period, insiders sold 400,000 shares at an average of 367. In May alone, NVR insiders sold \$113.5 million worth of stock. What bothers this pro is that NVR's Rabbi Trust Fund, which manages NVR's deferred-compensation plan for top execs, was able to buy shares in the open market at just 219. He says rather than buy back shares, NVR should pay dividends, given its strong cash flow and profits. In 2001, NVR earned \$236 million, or \$24.86 a share. Zelman expects \$36.33 in 2002. The shorts don't question management's competence nor the \$16 million bonus paid to CEO Dwight Schar. They wonder why insiders have been big sellers. On Oct. 28, 2002, Schar sold 18,000 shares at 336.33 a share, leaving him with 882,000 shares. NVR declined to answer the questions raised by the shorts.

How Wendy's Stayed Out Of the Fire

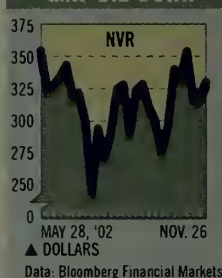
Is Wendy's International (WEN) set to emerge as victor in the price war it refused to join? Wendy's has seen its stock tumble—along with that of other fast-food chains, including McDonald's, which started the price-cutting. Wendy's is now close to its 52-week low of 26 a share.

McDonald's was first to offer hamburgers, including its Tasty quarter-pounder, for \$1. Burger King responded with a double cheeseburger for 99¢. "The price war has spooked investors," says Roger Lipton, general partner at RHL Associates, whose portfolio of consumer stocks has gained 15% this year, after a 40% gain in 2001. He's betting on Wendy's, which he calls "the best-run food chain in the U.S.," to hit 40 in 18 months. The price war won't last, predicts Lipton. He says McDonald's will have to abandon its dollar menu because of pressure from its own franchisees, who oppose the cuts. Wendy's, with more than 5,600 restaurants, of which 4,400 are franchised, is the strongest player in the industry. It trades at 12.5 times his 2003 earnings estimate of \$2.30 a share, and six times cash flow. Dennis Milton of Standard & Poor's rates Wendy's a buy and says the price war hurt rivals' long-term expansion plans. Wendy's, by contrast, gained share by offering higher-quality products, he says.

THE SIZZLE HAS FIZZLED



THE HAMMERING MAY DIE DOWN



Napco Helps Keep The Homeland Safe

With homeland security much in the news, Napco Security Systems (NSSC) has seen shares shoot from 6 in June to 9.80 on Nov. 26. Napco makes electronic locks and fire burglar alarms. The stock's rise reflected

sharp jump in earnings: In fiscal 2002 ended June 30, profits hit 38¢ a share, up from 2001's 7¢, although sales rose only slightly, from \$54 million to \$55.8 million. No major Street firm covers Napco, but Arsen Mrakovcic of Larchmont Capital, which has a sizable stake, says that, in two years, Napco could earn \$1.25 a share on sales of \$85 million. He says the stock should hit 20 in a year. Mrakovcic calls Napco an undiscovered value-growth play, trading at book value of 10 a share. Insiders own big stakes—Richard Soloway holds 30%. Customers include the IRS, airports in New York and New Jersey, and Caesars Palace.

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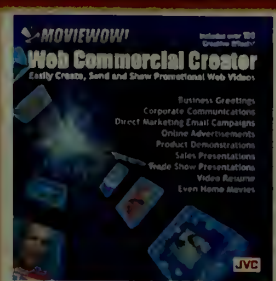
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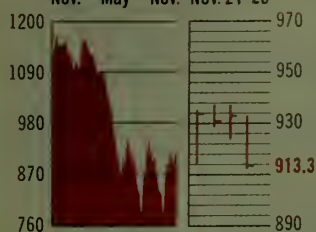
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Nov. May Nov. Nov. 21-26



COMMENTARY

After a seven-week rally, profit-taking prompted the stock market to stumble for the week ended Nov. 26. The pullback was despite some decent economic news: Third-quarter GDP was revised up to a 4.0% annual rate, from 3.1%; the Consumer Confidence Index rose in October to break a string of five straight monthly declines; and new home sales remain fairly strong.

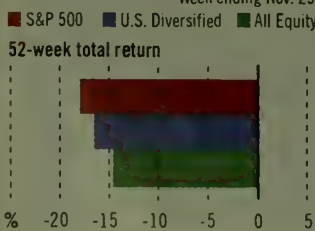
Data: Bloomberg Financial Markets (Reuters)

MUTUAL FUNDS

Week ending Nov. 25



Week ending Nov. 25



Data: Standard & Poor's

U.S. MARKETS

	NOV. 26	WEEK	% CHANGE YEAR TO DATE	LAST 12 MONTHS
S&P 500	913.3	-0.1	-20.4	-21.1
Dow Jones Industrials	8676.4	0.6	-13.4	-13.1
NASDAQ Composite	1444.4	1.8	-25.9	-25.6
S&P MidCap 400	438.0	0.8	-13.8	-10.4
S&P SmallCap 600	201.0	1.8	-13.4	-7.5
Wilshire 5000	8635.6	0.2	-19.4	-19.1

SECTORS

	NOV. 26	WEEK	% CHANGE YEAR TO DATE	LAST 12 MONTHS
BusinessWeek 50*	554.8	-1.9	-24.0	-26.3
BusinessWeek Info Tech 100**	308.9	2.3	-26.3	-26.7
S&P/BARRA Growth	471.3	-0.5	-20.7	-21.8
S&P/BARRA Value	438.8	0.3	-20.5	-20.9
S&P Energy	178.3	-3.1	-15.6	-11.3
S&P Financials	306.6	-1.4	-13.7	-14.3
S&P REIT	90.2	0.7	-3.4	-1.6
S&P Transportation	167.2	-1.3	-15.1	-14.1
S&P Utilities	93.7	1.7	-35.8	-36.7
GSTI Internet	85.7	2.5	-18.3	-17.8
PSE Technology	498.4	2.3	-27.5	-27.6

*Mar. 19, 1999 = 1000

**Feb. 7, 2000 = 1000

BEST-PERFORMING GROUPS

	LAST MONTH %	LAST 12 MONTHS %
Office Electronics	34.3	26.2
Instrumentation	25.1	24.5
Telecomms. Equipment	24.8	22.7
Networking Equipment	23.1	22.7
Computer Stge. & Perphs.	22.5	17.8

EQUITY FUND CATEGORIES

4-WEEK TOTAL RETURN	%	52-WEEK TOTAL RETURN	%
LEADERS		LEADERS	
Technology	18.2	Precious Metals	49.8
Communications	13.2	Real Estate	5.9
Small-cap Growth	8.0	Diversified Emerging Mkts.	-0.1
Small-cap Blend	7.4	Natural Resources	-0.9
LAGGARDS		LAGGARDS	
Precious Metals	0.1	Communications	-36.2
Japan	1.3	Technology	-33.6
Diversified Pacific/Asia	1.6	Health	-27.6
Health	2.1	Utilities	-23.3

EQUITY FUNDS

4-WEEK TOTAL RETURN	%	52-WEEK TOTAL RETURN	%
LEADERS		LEADERS	
ProFunds UltraSemicondr.	38.3	First Eagle SoGen Gold	81.5
Fifth Third Tech. Inv. A	36.9	Monterey OCM Gold	66.6
Firsthand Tech. Innovators	35.4	Gabelli Gold	63.8
Apex Mid Cap Growth	35.3	Tocqueville Gold	63.6
LAGGARDS		LAGGARDS	
ProFunds UltraShort OTC	-27.5	ProFunds UltraWireless	-75.7
Rydex Dynam. Vent. 100	-27.4	Wrl. GenomicsFund.com	-62.4
Fidelity Sel. Medical Del.	-23.2	ProFunds UltraOTC Inv.	-62.0
Potomac OTC Short	-14.5	Rydex Dynam. Veloc. 100	-60.8

GLOBAL MARKETS

	NOV. 26	WEEK
S&P Euro Plus (U.S. Dollar)	860.6	0.7
London (FT-SE 100)	4071.0	-0.6
Paris (CAC 40)	3215.2	2.0
Frankfurt (DAX)	3191.6	-0.7
Tokyo (NIKKEI 225)	8824.0	4.3
Hong Kong (Hang Seng)	9995.5	0.2
Toronto (S&P/TSX Composite)	6477.8	-0.2
Mexico City (IPC)	5922.4	5.0

FUNDAMENTALS

	NOV. 25	WK.
S&P 500 Dividend Yield	1.69%	1.
S&P 500 P/E Ratio (Trailing 12 mos.)	30.3	25
S&P 500 P/E Ratio (Next 12 mos.)*	17.0	16
First Call Earnings Revision*	-2.42%	-2.

TECHNICAL INDICATORS

	NOV. 25	WK.
S&P 500 200-day average	985.9	989
Stocks above 200-day average	28.0%	22
Options: Put/call ratio	0.68	0.6
Insiders: Vickers NYSE Sell/buy ratio	1.95	1.5

WORST-PERFORMING GROUPS

	LAST MONTH %	LAST 12 MONTHS %
Health-Care Facilities	-38.7	Multi-Utilities
Drug Chains	-17.5	IT Consulting
Managed Health Care	-17.0	Telecomms. Equip.
Home Improvement Stores	-14.5	Wireless Services
Health-Care Services	-13.5	Tires & Rubber

INTEREST RATES

KEY RATES

	NOV. 26	WEEK AGO
MONEY MARKET FUNDS	1.17%	1.22%
90-DAY TREASURY BILLS	1.22	1.21
2-YEAR TREASURY NOTES	1.93	1.94
10-YEAR TREASURY NOTES	4.07	4.06
30-YEAR TREASURY BONDS	4.94	4.94
30-YEAR FIXED MORTGAGE†	5.98	5.98

†Bar

BLOOMBERG MUNI YIELD EQUIVALENTS

Taxable equivalent yields on AAA-rated, tax-exempt municipal bonds, assuming a 30% federal tax rate

	10-YR. BOND
GENERAL OBLIGATIONS	3.97%
TAXABLE EQUIVALENT	5.67
INSURED REVENUE BONDS	4.04
TAXABLE EQUIVALENT	5.77

THE WEEK AHEAD

PURCHASING MANAGERS' INDEX Monday, Dec. 2, 10 a.m. EST ► The Institute for Supply Management's November industrial activity index is forecast to have risen to 50%, the point between growth and contraction, up from 48.5% in October. That's based on the median forecast of economists surveyed by MMs International.

CONSTRUCTION SPENDING Monday, Dec. 2, 10 a.m. EST ► Building outlays in October probably held steady, following a 0.6% jump in September.

VEHICLE SALES Tuesday, Dec. 3 ► Sales of U.S.-made and imported cars and light trucks very likely rebounded to an annual rate of 16 million units in November, after tumbling to 15.3 million in October.

FACTORY INVENTORIES Wednesday, Dec. 4, 10 a.m. EST ► Manufacturing inventories in October probably fell by 0.4%, after holding steady in September.

EMPLOYMENT Friday, Dec. 6, 8:30 a.m. EST ► Nonfarm payrolls in November most

likely grew by 30,000 positions, manufacturers probably cut 25,000. In October, payrolls fell by 5,000, 49,000 factory jobs lost. The unemployment rate very likely inched up with the average workweek expected to have lengthened to 34.2 hours.

INSTALLMENT CREDIT Friday, Dec. 6, 3 p.m. EST ► Consumers probably an additional \$6.5 billion of new credit in October. In September, growth in consumer credit swelled by \$10 billion.

BUSINESSWEEK FIFTY

May

Nov.

Daily: Nov. 21-26

590

575

560

554.8

545

530

Weekly

slid 1.9% this week. Large-cap blue chips such as Johnson & Johnson, Pfizer, Freddie Mac, and PepsiCo fell from between 2% and 6%. Wellpoint Health Networks suffered the largest hit, down 14.2%, on an analyst report that forecasted higher prices. Electronic Data Systems gained 16.4% despite a slight downgrade of its corporate bonds.

PERFORMANCE

% CHANGE

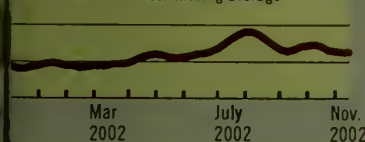
% CHANGE

COMPANY	WEEK	SINCE 3/1/02	RANK	COMPANY	WEEK	SINCE 3/1/02
Johnson & Johnson	-6.0	-7.4	26	Tenet Healthcare	-2.0	-54.5
Freddie Mac	-2.0	-10.6	27	Household International	-6.1	-47.7
	-3.9	-22.3	28	WellPoint Health Networks	-14.2	4.6
	-2.8	-8.7	29	Washington Mutual	4.1	11.1
Morris	-0.9	-28.8	30	Duke Energy	6.4	-43.9
Encor	7.4	-26.1	31	Kohl's	1.9	-1.5
Freddie Mac	-1.8	-20.8	32	Bed Bath & Beyond	-3.4	0.8
s	4.6	-12.4	33	Cardinal Health	-6.1	-7.6
Buy	4.2	-43.0	34	Centex	5.0	-16.9
SourceBergen	-3.4	-13.9	35	American Electric Power	5.3	-35.9
Health Group	-11.9	9.1	36	Golden West Financial	0.6	8.1
n	0.3	1.4	37	Stryker	-8.0	-0.1
Depot	1.3	-50.0	38	Harley-Davidson	-4.2	-7.5
Art Stores	-2.1	-14.1	39	PepsiCo	-5.2	-17.9
y	11.3	-95.0	40	Merck	2.0	-4.4
ral Dynamics	-0.5	-11.9	41	Apache	-1.3	-1.8
coPhillips	-4.6	-20.0	42	Amerada Hess	0.5	-20.2
t Laboratories	2.5	33.5	43	KB Home	0.0	-0.2
(H&R)	2.8	-23.7	44	First Data	-1.7	-17.4
ne	28.6	-41.9	45	Tyco International	4.1	-41.3
ental Petroleum	-1.7	2.2	46	International Game Technology	-1.3	14.4
	-6.3	-0.9	47	Capital One Financial	12.2	-33.1
Homes	1.9	-12.1	48	Electronic Data Systems	16.4	-70.6
hon Oil	-1.1	-29.0	49	Nabors Industries	-9.0	-3.6
oup	-1.7	-12.4	50	Xcel Energy	0.5	-55.4

PRODUCTION INDEX

Change from last week: 0.0%
Change from last year: 1.6%

INDUSTRIAL OUTPUT Nov. 16=162.5 1992=100
The index is a 4-week moving average



Production index was unchanged during the latest calculation of the four-week moving average. The index rose from 162.2 to 162.5. On a seasonal basis, coal and rail-freight traffic showed gains, with smaller gains in the output of steel. Crude-oil refining and electric power were the biggest decliners. Vehicle production was also lower, with autos falling more sharply than assemblies.

Each of the index components is at www.businessweek.com.
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A SEISMIC SHIFT TOWARD CHINA

Look East. While America is preoccupied with the Middle East, directing an occasional nod to an expanding NATO and Europe, an economic supernova is rising in Asia—Greater China. The integration of Taiwan and Hong Kong into the fast-growing Chinese economy is creating a boom that is attracting huge amounts of technology, capital, and skilled immigrant labor from all over the world. We are witnessing a macro-event of immense geopolitical and historic significance (page 50). It's time to ponder the rise of Greater China and the shifting fulcrum of international wealth and power.

Japan is being eclipsed. Europe is being challenged, and the U.S. is torn between benefiting from the Chinese economic dynamo and worrying about China's Big Power aspirations. The good news for America is that the most contentious issue between Beijing and Washington, the future of Taiwan, is quietly being determined not by invading fleets but by invading businessmen. Much of Taiwan's high-tech industry is moving en masse to China—and with it, some 400,000 Taiwanese. Taiwanese students are choosing to study in Chinese, not U.S., universities because they see more opportunity there. If China's political rulers can maintain their patience, the eventual political integration of Taiwan into China is almost a certainty.

What is not so certain is China's political direction. Greater China's share of total world exports already exceeds Japan's,

and its economic size will nearly match the European Union in five years. But the country is still a dictatorship, run by an atavistic Communist Party. How long this can last in a society increasingly open and mobile, both geographically and economically, remains to be seen.

Odds are China will follow two other authoritarian countries, Korea and Taiwan, which developed elective dictatorships after strong economic growth created middle-class societies. A democratic China would probably be more of an ameliorating tensions with other Asian countries and the U.S. in the future. China has outstanding territorial disputes with four Southeast Asian countries over the Spratly Islands and long-standing border disputes with India and Russia. The domination of Tibet is of concern to many Americans. China's desire to build a modern military force commensurate with its rising economic power worries the Pentagon.

China already resembles the U.S. in building a dynamic open economy that generates enormous opportunity and attracts students, immigrants, and investment from around the world. Washington should give China credit for this progress and allow it time to progress politically as well. And it must recognize that the evolution toward a democratic political system would cement its economic gains—and its place in the world, for generations of Chinese to come.

MAYOR BLOOMBERG'S MISTAKE

We don't fathom what New York Mayor Michael R. Bloomberg is up to these days. As an entrepreneur, he built an empire by being smart and innovative in a tough business environment. As a Republican mayor, he's punting on a chance to make New York's 300,000-strong public workforce more productive by relying largely on sharply higher taxes to finance a \$6 billion budget deficit. Bloomberg's taxes will almost certainly hurt New York's already fragile competitive position. Worse, the whole country could suffer if mayors and governors around the U.S. copy him and raise taxes. The National Bureau of Economic Research forecasts a combined state budget deficit of \$60 billion in 2003. Add in the red ink from cities and the total may hit \$80 billion. If governors and mayors raise taxes to solve this problem, the fiscal drag could cancel out the tax cuts being mulled by the Bush Administration for 2003.

For average people, the timing for new taxes couldn't be worse. Employees haven't seen much in the way of pay raises or bonuses for two to three years. Their 401(k)s are shot, their health benefits are skyrocketing, and their kids' college tuition is rising. They're putting in more hours than ever hoping to keep their jobs. Families feel besieged. Double-digit hikes in real estate, transportation, and commuter taxes would hurt.

Of course, the financial plight of New York and other lo-

calities is not all of their own making. Since September 11, cities have spent billions fighting terrorism. Congress promised to compensate them, then went home without offering a penny. Congress also promised to give states some \$9 billion to help pay for increases in Medicaid spending, then went away from this obligation as well.

That doesn't leave Mayor Bloomberg off the hook. For credit, he has taken control of New York's vast public system but hasn't yet made a serious effort to streamline costs. Only 50¢ of every dollar spent on education goes into the classroom. Police and fire emergency rescue teams duplicate their activities. City bureaucrats work far more hours than private-sector employees, and most receive generous defined pensions, while the corporate world makes do with precarious 401(k)s. There is a better way: higher productivity from the city's workforce. The private sector knows why. Why should we expect less from government?

In the '90s, Republican and Democratic mayors and governors counted on rising tax revenues from the sale of stock pay for more of everything. Even when the economy recovered fully from the recession, those revenues won't return. Now politicians are going to have to learn to do more with less. It's efficiency. Call it productivity. Call it what you want. New York's costs are too high, Mr. Mayor.



BusinessWeek

BER 16, 2002

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COVER STORY

THE FUTURE OF THE FED

Alan Greenspan has guided the U.S. economy through boom and bust. Will his approach prevail in coming years?

page 94



Cover Story

94 THE FUTURE OF THE FED

As Greenspan's extraordinary career enters the final phase, it's unclear what will come next. The Fed Chairman correctly foresaw he productivity revolution that let the U.S. grow rapidly without igniting inflation. As the excesses of the late 1990s become clearer, however, support for his New Economy monetary policy is weakening. But if the economy picks up and the markets recover, Greenspan's vision will prevail, and he may go down in history as the best Fed chief ever

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Who's Next?

First Wal-Mart gobbled up the mom-and-pop shops, then it mauled discount department stores. What category is the insatiable retailer gunning for now? You name it



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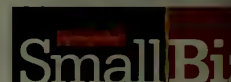
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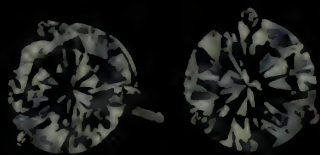
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Up Front

EDITED BY KIMBERLY WEISUL

MEDICAL CENTER

THERE'S A DOCTOR IN THE HOUSE

WITH HEALTH-CARE PREMIUMS expected to rise 14% to 19% next year, business will be hit hard. The exception: companies that have brought their health-care programs in-house. Once viewed as philanthropy, the practice is now getting attention as a major money-saver. "A lot more companies are realizing they can save money by taking more control of employee health care," says Dr. Wayne Lednar, Eastman Kodak's corporate medical director.

At Quad/Graphics, a print-



AN EYE TOWARD LOWER COSTS

er with 14,000 employees, the company's own doctors and nurses offer primary care on-site, and the company has a small network of specialists. Over the past four years,

TALK SHOW "I'm telling my people to make some loans with some hair on them."

—Henry L. Meyer III, CEO of KeyCorp, who thinks it's an opportune time to step up lending to the bank's corporate customers

STREET NEWS

E-MAIL? WHAT E-MAIL?



WAITING FOR W

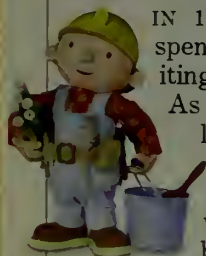
Street to pent? It co take a wh On Dec. 3, regulators for five firms—G man Sachs, M gan Stanley, C Group's Salon Smith Barr Deutsche Bank, and U Bancorp Piper Jaffray—to \$1.65 million each for fail to retain and store e-n properly. They're supposed keep electronic communi tions for three years a make sure they're easily cessible for two.

The \$1.65 million penalty piddling to the huge ban It's only a bit more than t \$1.35 million earned, on av age, by a senior managing rector in a year. Besides, pla ing by the rules can be t costlier. Merrill Lynch pa \$100 million in May to set with New York Attorney Ge eral Eliot Spitzer after found a trail of e-mail, dati back to 1999, that pointed conflicts of interest.

Yet the banks are whin The Securities Industry Ass complains that regulato need to better specify whic e-mail, exactly, firms must r tain. Hard to imagine wh there's so little trust in W Street. Emily Thornto

TOY STORY

SAINT NICK CONFIDENTIAL



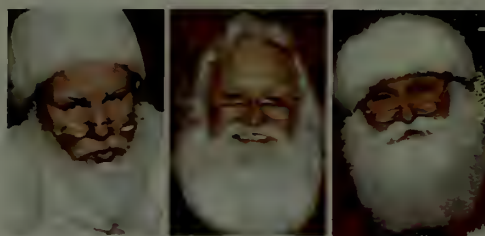
IN 1989, LISE BUYER spent a weekend visiting Santas in malls. As a retailing analyst, she thought it was the best way to find out which toys would become hot sellers. Buyer heard all about Ninja Turtles and endured plenty of funny looks, she says. "Who stands in line to see Santa with no kid?"

BusinessWeek reporters, that's who. Our own poll of

Santas predicts a banner year for Bob the Builder: Every Santa we visited said that toys based on Bob, star of a children's TV show, were favorites. "That's a good thing for society," says a San Mateo (Calif.) Santa, a.k.a. James Davis. "It means [kids] are thinking of building things instead of blowing things up."

In Atlanta, boys ask for video games and Power Rangers, while girls want Barbies and laptops. Chicago's a hot spot for Thomas the Tank Engine and Britney Spears CDs.

A New Jersey Santa, a.k.a.



SANTAS: Georgia, California, New Jersey

Raymond Beesley, says kids often ask for things without knowing quite what they are. Like vacuum cleaners. "They're always being told to clean their rooms, and they see ads with spotless rooms and vacuums, and that's what they want," he says. Maybe Santa can sweep the chimney while he's at it. Kimberly Weisul, with bureau reports

THE LIST GLOBAL COMPETITIVENESS

The U.S. is first in this year's ranking of the world's most competitive economies. Here are the five highest-ranked countries, along with the areas in which each excels:



UNITED STATES

Technological sophistication, spending on research and development



FINLAND

University enrollments, efficiency of legal system, ethical behavior of businesses



TAIWAN

Cell-phone ownership, technology innovation, competitiveness of local firms



SINGAPORE

National savings rate, math and science education, public trust of politicians



SWEDEN

High school enrollments, freedom of the press, access to phone lines

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Up Front

JOB SEARCH

HOLD THE BRAVADO, PLEASE

ONLY WING TIPS, WHITE SHIRTS, and humble attitudes need apply. While brokerages slash thousands of jobs for sell-side analysts and bankers—70,000 such cuts have been made since January, 2001—they're on the lookout for specialists in today's lucrative fields. Bond desks and wealth-services groups are hiring, as are hedge funds—with more than

200 new funds launched just last year. But according to a November survey from recruiter Russell Reynolds Associates, those doing the hiring are all saying the same thing: No hotshots, please.

"Superstar solo acts" won't get your foot in the door,

says Nicholas Hurd, managing director at Russell Reynolds. After seeing the troubles caused by the likes of Credit Suisse First Boston's Frank Quattrone and Salomon Smith Barney's Jack Grubman, firms no longer want any department to be too closely linked with any one personality. Even mutual-fund companies such as Putnam are promoting management "teams" rather than star fund "managers."

Besides toning down the bravado, seasoned Wall Streeters looking for jobs must lower their salary expectations, the survey says. Firms are keen on candidates who aren't primarily motivated by money.

What? A job on Wall Street for the pure joy of it? The times, they are a-changing. *Mara Der Hovanesian*



DRAWN & QUARTERED

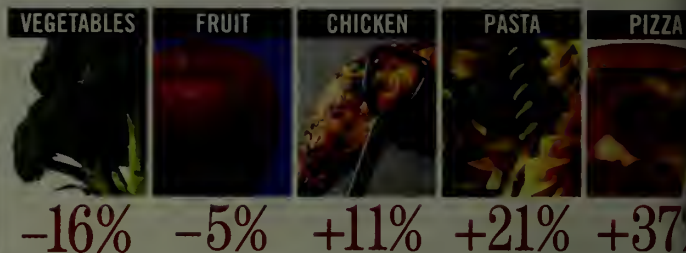
WHAT WILL IT TAKE BEFORE AMERICANS GET UPSET ABOUT FEDERAL SPYING?



GREEN WATCH

NO BRUSSELS SPROUTS FOR ME

THE NUMBER OF SIDE DISHES SERVED WITH MEALS IS DECLINING, which means Americans are eating fewer fruits and vegetables. Here's how the average American's diet has changed since 1990:



FINAL ACTS

IT'S YOUR RODEO—ER, FUNERAL

BABY BOOMERS HAVE NEVER been content to go through life quietly, and it looks as if they will be no different in death. Undertakers are reporting a boom in "themed" funerals, where clients design

services celebrating the deceased's passions—from hunting to cooking. "Baby boomers seem to want to gain possession of the funeral service and forgo the traditional," says David Walkinshaw of the National Funeral Directors Assn. With boomers getting involved in the planning, the NFDA says that half of funerals now have themes.

Such services can be as elaborate as the Burbank (Calif.) ceremony for a boxer that featured a real boxing ring. Others simply include personal memorabilia from the dead person. Wade Funeral Home in St. Louis, like other funeral parlors, is building permanent sets to accommodate some themes. Mourners in "Big Mama's Kitchen" can share the deceased's favorite recipes, cooked on the

spot. Wade's parent company, Perpetua, plans to expand in the Midwest and East by building 50 funeral homes with sets, including real fish ponds for fishermen.

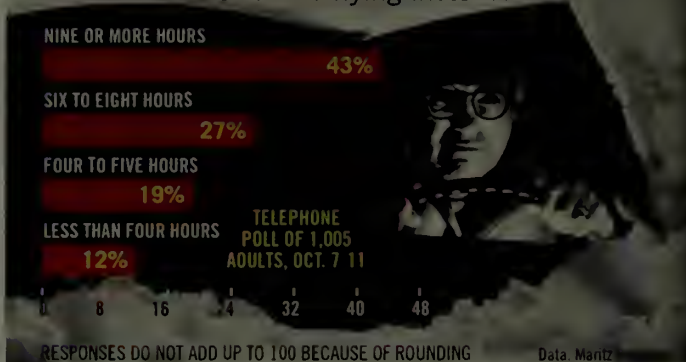
Themed funerals don't have to cost more, since the coffin is no longer the center of attention. At a themed fu-

neral, "instead of a \$3,000-\$5,000 casket, the family might spend \$295," on it, says funeral director Michael Kubasak. What's more, family members and friends often provide the props. For the boxer, says Kubasak, the ring was supplied free by his gym. *Cathy Schottenstein*

THE BIG PICTURE

TAKING THE HIGH ROAD

How much road-tripping is too much? Here's how long travelers say they're willing to drive before they consider flying instead:



Polls, surveys, and other items for consideration in this section should be sent to upfront@businessweek.com



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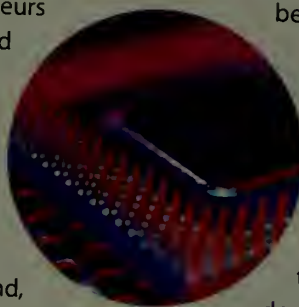
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Innovate

Their chips are inside the box because they keep thinking outside the box: Taiwan keeps on filling the world's IT orders with value and ingenuity

Where can you find an island of entrepreneurs surrounded by majestic rocky cliffs and tranquil beaches, where minorities peacefully coexist, the population is 94% literate, and where they have a constitutional democracy, a smart, young president and a female vice president? Sound too good to be true? Well, Taiwan, sometimes called Silicon Island, is no figment of the imagination. Taiwan, the Republic of China, is the world's third largest overall producer of information technology products, exporting a record of more than US\$45 billion worth of computer and communications products this year. What's more, this little island continues to reinvent itself.

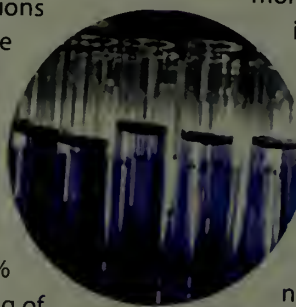
One of the few Asian countries to make it out of the economic crisis relatively unscathed, Taiwan's economic growth has averaged 9% annually since 1970. With this year's full-year forecast at 3.27% that means the technology crisis is a thing of the past. Taiwan has been supplying behind the scenes, filling orders for all the world's big IT brands. As an early player in the computer revolution, Taiwan has



become the world's largest producer of notebook computers, motherboards, scanners, modems, mice, monitors and keyboards. Everyone from Nokia to IBM has come to rely on the value that Taiwan's brands are offering.

Perhaps Taiwan's secret to success lies in the word *innovalue*, a new term coined to describe innovation and value – both of which have been an integral part of Taiwan's ability to produce revolutionary, cutting edge products and services while assuring their customers of value for money. Taiwan has not claimed to be the most innovative, but its role has been to transform technological breakthroughs into products real consumers can use at a price they can afford.

Taiwan is the manufacturing and R&D center for many of the world's most innovative new products, including notebook computers, PDAs, CLD PCs (such as the new Apple iMac), TFT LCDs, WLAN systems, smartphones, high-end bicycle components, and high-tech golf club heads. Taiwan sells computer



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components to all the major brands, including Hewlett Packard (HP), Dell, IBM and Apple as well as major Japanese manufacturers. When the big boys come looking for contracts for their OEM products, Taiwan is ready with competitive prices, high quality and super high production levels.

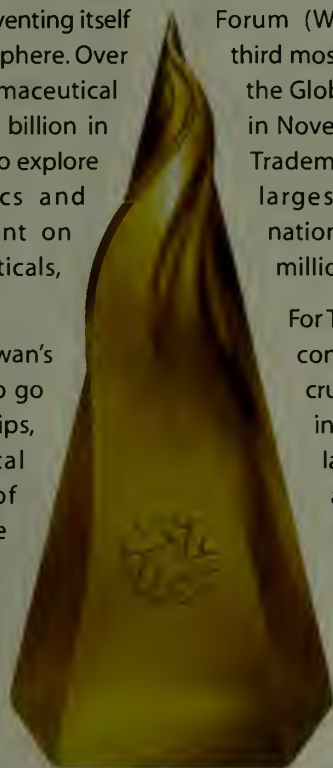
Taiwan's next frontier is biotechnology. Riding the tech boom has been and continues to be great, but this Silicon Island is taking no chances and reinventing itself to assure a golden future in the biotech sphere. Over the next five years biotech and pharmaceutical operations are expected to invest US\$5 billion in Taiwan's biotech industry, as they set out to explore hot areas such as human genomics and bioinformatics. R&D will also be spent on diagnostics, biochips, raw pharmaceuticals, biopolymers and Chinese medicine.

Some companies are leveraging on Taiwan's precision engineering and IT expertise to go into such areas as bioinformatics, biochips, medical devices and pharmaceutical engineering. Taiwan's knowledge of traditional Chinese medicines will also be important as Mainland China and Taiwan both invest and collaborate in taking many herbal remedies into the mainstream. Taiwan's government has made a commitment to spend about

US\$300 million a year for the next five years in addition to a development fund of about US\$600 million that was started in 1997 to invest in biotech ventures. This initiative will create 500 biotech companies in the next decade and create 25,000 jobs.

As the world's 14th largest trading nation with a per capita income of more than US\$13,000, Taiwan is ready for the big leagues. The World Economic Forum (WEF) recently ranked Taiwan as the third most competitive economy in the world in the Global Competitiveness Report published in November 2002. In 2000, the U.S. Patent & Trademark Office granted Taiwan the third largest number of patents to foreign nationals. That's not bad for an island of 22 million people.

For Taiwan there are many other factors that contribute to its success, including the crucial support of institutions for their role in protecting property rights, the rule of law, efficiency of government spending and transparency in all levels of government. As Taiwan's brands are recognized for their manufacturing excellence, award-winning design, innovations and value, the future looks bright for this island of technology and biotech winners.


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A RESPONSE FROM
KEN LIPPER

The central premise of your article "The fallen financier" (Cover Story, Dec. 9) is simply wrong and without basis in fact. There was no lack of vigilance or oversight at Lipper & Co. on my part or that of other senior management. We were actively involved in the firm's business on a daily basis.

Neither I nor any other member of senior management had knowledge of any issues regarding the valuations of the securities held by the convertible funds. The convertible funds were fully audited by PricewaterhouseCoopers, which had all the relevant information. No issue about pricing was ever raised by them. These issues came to light only after the portfolio manager abruptly left, and I immediately launched an internal review. When we found the valuation problem, we set about to correct it promptly and responsibly and to devise an appropriate course of action.

An independent investigation, which was conducted by the law firm Fried, Frank, Harris, Shriver & Jacobson, supports these facts. It concludes: "There is no evidence that senior management knew that [Executive Vice-President and Portfolio Manager Edward] Strafacci was improperly valuing the securities of the Lipper Convertible Funds prior to Strafacci's departure on 1/14/02."

For the past 10 months, Lipper & Co. has been totally focused on uncovering the nature of this problem and acting to rectify it to the greatest extent possible. We took great pains to wind down the positions in a way that maximized value for our investors without disrupting the markets. We were successful in those efforts. Under our proposed plan of distribution, the av-

erage investor would receive back of his or her original investment.

Kenneth Lipper
Chairman &
Lipper &
New York

Editor's note: As noted in the story, Mr. Lipper declined numerous interview requests by BusinessWeek.

EXECUTIVE MOMS AT HOME:
PROGRESS OR PRIVILEGE?

The privilege of "stopping out" is most entirely the provenance of women from wealthy households ("Mommy really home from work," Working Woman, Nov. 25). I have always known that many women have to return to work when their child is six weeks old, after their paid leave runs out. The next time I take a business trip, I hope my home room will not have just been cleaned by a woman who has a six-week-old child and is working inflexible hours to receive less than a living wage.

Maureen A. Scully
Boston

One of the backlash problems caused by female high achievers "stopping out" is the unpleasant ripple effect it has on those of us educated women who have chosen not to have children. I will probably be 60 years old before I can be in a corporate environment and not feel that management intuitively lumps me in the same category as 99% of working women, i.e., wondering at what point I'll jump ship to have a family.

Given their high dropout rate from corporate life because of family demands, women need to reassess the complaints about unequal pay and realize how equally unfair it is of them to expect corporations, which need employees who are focused and produ-

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RECTIONS & CLARIFICATIONS

The Zagat guide to just about everything (News: Analysis & Commentary, Dec. 1) charged to access zagat.com should be \$14.95 per year, not \$14.95 per month.

"Waters of the world, unite" (Up Front, Dec. 9) incorrectly identified a coalition of various congregations trying to discourage use of sport-utility vehicles. The group is called the Interfaith Climate & Energy Campaign.

In these tough economic times, to stand at will to their discretionary expenses of absence.

Linda VanderVrede
Scottsdale, Ariz.

As for full-time motherhood being a drawback for feminism, my view is that successes have allowed me to "buy" myself the option—the luxury—to stay home and be the one to prepare my food for the world ahead of him. Feminism should be about having all options available so that we can pick and choose the one that work best for us.

Anne Goodrich
Calistoga, Calif.

EMO ISN'T AS BRUTAL IT USED TO BE

I am the two-time survivor of breast cancer with whom Catherine Arnst ended the story "Cancer: The hope. The reality. The reality" (Special Report, Nov. 1). She wrote: "Colmore went through brutal chemo regimen." While I can't say I enjoyed feeling exhausted and utterly nauseous for a couple of days after chemotherapy, I was able to go to work three days after chemo and, in general, I had a life during the treatment. With the effective and varied anti-nausea drugs used today, most of us can do chemo and pretty much keep up with our lives. The public is still traumatized by our parents' generation's experience of brutal chemotherapy.

Perry Colmore
Cambridge, Mass.

CHEF SOLUTIONS SAYS ITS LABOR RELATIONS ARE JUST FINE

"The UAW answers a cry for help" (Up Front, Nov. 18), regarding Chef Solutions Inc.'s North Haven (Conn.) facility, indicated that some female employees complained of sexual harassment at the facility. Please allow us to

clarify the record. Chef Solutions has owned this facility for about two years. While complaints of sexual harassment have been filed with a state agency, many of these allegations were prior to our ownership. Even though the accused managers are no longer with the company, we are investigating the validity of the complaints and are working to resolve them.

Your readers should also know that employees at the plant voted against union representation. The company is working with the National Labor Relations Board to resolve union complaints about the vote. We respect all of our employees' rights under the law, including their right to decide upon representation.

Trish Beck
Senior Vice-President
for Human Resources
Chef Solutions Inc.
Schaumburg, Ill.

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BUSH AT WAR

By Bob Woodward

Simon & Schuster • 376pp • \$28

INSIDE THE WHITE HOUSE AFTER SEPTEMBER 11

Several months ago, a colleague and I were quietly ushered into Defense Secretary Donald H. Rumsfeld's office for an interview. Unaware of our presence because his back was to us, Rumsfeld told an aide: "You know, I don't agree with Colin on a single point in this memo." We didn't know the document's subject, but it didn't matter—the comment could have applied to any number of issues faced jointly by Rumsfeld and Secretary of State Colin L. Powell.

The much-publicized conflict between the two is a recurring theme in Bob Woodward's *Bush at War*, an account of the Administration's first 100 days after September 11. *The Washington Post* assistant managing editor provides readers with a wealth of fly-on-the-wall detail from deliberations within the Cabinet. But don't expect much insight into the Rumsfeld-Powell tiffs. Do they reflect different personalities, world views, or institutional imperatives? Or, perhaps more significantly, is the cleavage evidence of continuing tension between the Pentagon's civilian leadership and the uniformed services, for whom ex-General Powell seems to have more affinity than Rumsfeld does?

The events following September 11 show that the fights between Defense Dept. suits and the generals can have serious consequences. Readers, contemplating the services' delay in providing a war plan and troops for Afghanistan, will long to know if this was a slap at Rumsfeld, who had made clear his contempt for the military's failure to adopt what he saw as 21st century notions of war. Woodward is of little help on such matters.

Why is it that Bush often talks tough like Rumsfeld and Vice-President Dick Cheney but then acts like the more moderate Powell? Is this a conscious strategy of throwing rhetorical bones

to the GOP conservative base while avoiding deeds that might upset U.S. allies? Is it an indication of a behind-the-scenes alliance between Powell and influential National Security Advisor Condoleezza Rice or simply evidence of a vacillating foreign policy?

Again, Woodward's treatment is disappointing. He conducted interviews with more than 100 officials and obtained access to numerous top-secret intelligence memos and notes from more than 50 confidential National Security Council meetings at which the war on Afghanistan was planned. Yet Woodward seems like a dog who finally catches a car and doesn't know what to do with it. He's long on access but short on critical analysis.

Nevertheless, the abundant facts presented in *Bush at War* are illuminating. Often, it seems, lively debate within the national security team leads to sounder policy. At two meetings on the day after September 11, for example, top officials discussed how to respond. Bush said he wanted to focus simply on al Qaeda—an approach he felt the American people would understand and support. Rumsfeld argued for a broader, global campaign against terrorism. Powell agreed with Bush, saying it would be easier to enlist a broad coalition and even U.N. support for a purely anti-al Qaeda offensive. Cheney wanted to hit state sponsors of terrorism, arguing that the goal should define the coalition rather than the other way around. Rumsfeld then raised Iraq as a possible target. In the end, the Powell-Bush view prevailed, but hashing out the benefits and risks of each option made for wiser choices.

Woodward's portraits of the participants are, for the most part, superfi-

cial. One who receives more attention and a thoroughgoing defense of his conduct both before and after September 11—is Central Intelligence Agency rector George J. Tenet. In fact, Tenet comes across as perhaps the critical figure in the entire effort. Woodward shows how the CIA devised the Afghanistan plan and won the support of key Afghan warlords—in part by shelling out millions of dollars. In this light, despite pre-September 11 intelligence lapses, Tenet's post-September 11 performance is easy to defend.

The book also contains revealing material on Bush and his relationship with Rice. Deeply religious and a bit of a fatalist, the President finds the stress and conviction to return to Washington

immediately after the terrorist attacks despite warning of ongoing danger. Bush comes across as an impatient boss who pushes his troops, yet Rice has the ability to rein him in. On Friday, September 28, for example, the president's team—which included Powell, Rumsfeld, Rice, Cheney, and Tenet—was scheduled to meet and decide when to launch the Afghan attack. Bush wanted

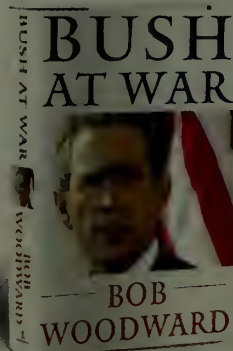
to move, but Rice informed him on the night before the gathering that the Pentagon and CIA weren't ready. Then, she told Rumsfeld to expect a disappointed President, and she urged the Defense Secretary to give Bush a realistic time frame for action. At the meeting, Bush eased off, allowing the attack to be delayed until preparations were in order.

Once the offensive got started, progress proved agonizingly slow. Tenet, Woodward asserts, caused officials more concern than they displayed publicly. According to *Bush at War*, the most unflappable player during this period was Bush himself.

That kind of patience will be needed in the future. Recent bombings in Iraq and Kenya show that the war against terrorism is far from over. Neither suspect, is the scrutiny of the Bush team's performance during that 100-day period. Woodward's book is just a first, very rough draft of that key chapter in America's history.

BY STAN CROCK

Crock covers defense policy from Washington.



WOODWARD'S ACCOUNT IS LONG ON ACCESS AND SHORT ON INSIGHT AND ANALYSIS

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• Adverse events possibly, probably or definitely related to use of AndroGel in a 1-year follow up (n=106) across all dose levels reported in at least 2% of patients included application site reaction 9.4%, prostate disorder 8.5%, acne 5.7%, and lab test abnormal 4.7%.



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• Androgens are contraindicated in men with a history of the breast, or known or suspected carcinoma of the prostate. Geriatric patients treated with androgens may be at an increased risk for the development of hyperplasia and prostatic carcinoma.

• To minimize the potential transfer of testosterone to another person, patients should wash their hands immediately with soap and water after application of AndroGel. They should cover the application site with clothing after the gel has dried.

Please see brief summary of prescribing information.

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1. www.fda.gov/fdac/departs/196_upd.html, accessed May 17, 2002

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INDICATIONS AND USAGE

AndroGel® is indicated for replacement therapy in males for conditions associated with a deficiency or absence of endogenous testosterone:

1. Primary hypogonadism (congenital or acquired)—testicular failure due to cryptorchidism, bilateral torsion, orchitis, vanishing testis syndrome, orchiectomy, Klinefelter's syndrome, chemotherapy, or toxic damage from alcohol or heavy metals. These men usually have low serum testosterone levels and gonadotropins (FSH, LH) above the normal range.
2. Hypogonadotropic hypogonadism (congenital or acquired)—idiopathic gonadotropin or luteinizing hormone-releasing hormone (LHRH) deficiency or pituitary-hypothalamic injury from tumors, trauma, or radiation. These men have low testosterone serum levels but have gonadotropins in the normal or low range.

AndroGel® has not been clinically evaluated in males under 18 years of age.

CONTRAINDICATIONS

Androgens are contraindicated in men with carcinoma of the breast or known or suspected carcinoma of the prostate.

AndroGel® is not indicated for use in women, has not been evaluated in women, and must not be used in women.

Pregnant women should avoid skin contact with AndroGel® application sites in men. Testosterone may cause fetal harm. In the event that unwashed or unclothed skin to which AndroGel® has been applied does come in direct contact with the skin of a pregnant woman, the general area of contact on the woman should be washed with soap and water as soon as possible. *In vitro* studies show that residual testosterone is removed from the skin surface by washing with soap and water.

AndroGel® should not be used in patients with known hypersensitivity to any of its ingredients, including testosterone USP that is chemically synthesized from soy.

WARNINGS

1. Prolonged use of high doses of orally active 17-alpha-alkyl androgens (e.g., methyltestosterone) has been associated with serious hepatic adverse effects (peliosis hepatis, hepatic neoplasms, cholestatic hepatitis, and jaundice). Peliosis hepatis can be a life-threatening or fatal complication. Long-term therapy with testosterone enanthate, which elevates blood levels for prolonged periods, has produced multiple hepatic adenomas. Testosterone is not known to produce these adverse effects.
2. Geriatric patients treated with androgens may be at an increased risk for the development of prostatic hyperplasia and prostatic carcinoma.
3. Geriatric patients and other patients with clinical or demographic characteristics that are recognized to be associated with an increased risk of prostate cancer should be evaluated for the presence of prostate cancer prior to initiation of testosterone replacement therapy. In men receiving testosterone replacement therapy, surveillance for prostate cancer should be consistent with current practices for eugonadal men (see PRECAUTIONS: Carcinogenesis, Mutagenesis, Impairment of Fertility and Laboratory Tests).
4. Edema with or without congestive heart failure may be a serious complication in patients with preexisting cardiac, renal, or hepatic disease. In addition to discontinuation of the drug, diuretic therapy may be required.
5. Gynecomastia frequently develops and occasionally persists in patients being treated for hypogonadism.
6. The treatment of hypogonadal men with testosterone esters may potentiate sleep apnea in some patients, especially those with risk factors such as obesity or chronic lung diseases.

PRECAUTIONS

Transfer of testosterone to another person can occur when vigorous skin-to-skin contact is made with the application site (see Clinical Studies). The following precautions are recommended to minimize potential transfer of testosterone from AndroGel®-treated skin to another person:

- Patients should wash their hands immediately with soap and water after application of AndroGel®.
- Patients should cover the application site(s) with clothing after the gel has dried (e.g., a shirt).
- In the event that unwashed or unclothed skin to which AndroGel® has been applied does come in direct contact with the skin of another person, the general area of contact on the other person should be washed with soap and water as soon as possible. *In vitro* studies show that residual testosterone is removed from the skin surface by washing with soap and water.

Changes in body hair distribution, significant increase in acne, or other signs of virilization of the female partner should be brought to the attention of a physician.

General

The physician should instruct patients to report any of the following:

- Too frequent or persistent erections of the penis.
- Any nausea, vomiting, changes in skin color, or ankle swelling.
- Breathing disturbances, including those associated with sleep.

Information for Patients

Advise patients to carefully read the information brochure that accompanies each carton of 30 AndroGel® single-use packets.

Advise patients of the following:

- AndroGel® should not be applied to the scrotum.
- AndroGel® should be applied once daily to clean, dry skin.
- After application of AndroGel®, it is currently unknown for how long showering or swimming should be delayed. For optimal absorption of testosterone, it appears reasonable to wait at least 5-6 hours after application prior to showering or swimming. Nevertheless, showering or swimming after just 1 hour should have a minimal effect on the amount of AndroGel® absorbed if done very infrequently.

Laboratory Tests

1. Hemoglobin and hematocrit levels should be checked periodically (to detect polycythemia) in patients on long-term androgen therapy.
2. Liver function, prostatic specific antigen, cholesterol, and high-density lipoprotein should be checked periodically.
3. To ensure proper dosing, serum testosterone concentrations should be measured (see DOSAGE AND ADMINISTRATION).

Drug Interactions

Oxyphenbutazone: Concurrent administration of oxyphenbutazone and androgens may result in elevated serum levels of oxyphenbutazone.

Insulin: In diabetic patients, the metabolic effects of androgens may decrease blood glucose and, therefore, insulin requirements.

Propranolol: In a published pharmacokinetic study of an injectable testosterone product, administration of testosterone cypionate led to an increased clearance of propranolol in the majority of men tested.

Corticosteroids: The concurrent administration of testosterone with ACTH or corticosteroids may enhance edema formation; thus, these drugs should be administered cautiously, particularly in patients with cardiac or hepatic disease.

Drug/Laboratory Test Interactions

Androgens may decrease levels of thyroxine-binding globulin, resulting in decreased total T4 serum levels and increased resin uptake of T3 and T4. Free thyroid hormone levels remain unchanged, however, and there is no clinical evidence of thyroid dysfunction.

Carcinogenesis, Mutagenesis, Impairment of Fertility

Animal Data: Testosterone has been tested by subcutaneous injection and implantation in mice and rats. In mice, the implant induced cervical-uterine tumors, which metastasized in some cases. There is suggestive evidence that injection of testosterone into some strains of female mice increases their susceptibility to hepatoma. Testosterone is also known to increase the number of tumors and decrease the degree of differentiation of chemically induced carcinomas of the liver in rats.

Human Data: There are rare reports of hepatocellular carcinoma in patients receiving long-term oral therapy with androgens in high doses. Withdrawal of the drugs did not lead to regression of the tumors in all cases.

Geriatric patients treated with androgens may be at an increased risk for the development of prostatic hyperplasia and prostatic carcinoma.

Geriatric patients and other patients with clinical or demographic characteristics that are recognized to be associated with an increased risk of prostate cancer should be evaluated for the presence of prostate cancer prior to initiation of testosterone replacement therapy.

In men receiving testosterone replacement therapy, surveillance for prostate cancer should be consistent with current practices for eugonadal men.

Pregnancy Category X (see Contraindications)—Teratogenic Effects: AndroGel® is not indicated for women and must not be used in women.

Nursing Mothers: AndroGel® is not indicated for women and must not be used in women.

Pediatric Use: Safety and efficacy of AndroGel® in pediatric patients have not been established.

ADVERSE REACTIONS

In a controlled clinical study, 154 patients were treated with AndroGel® for up to 6 months. Adverse events possibly, probably or definitely related to the use of AndroGel® and reported by ≥1% of the patients are listed in Table 1.

Table 1. Adverse Events Possibly, Probably or Definitely Related to Use of AndroGel® in the Controlled Clinical Trial

Adverse Event	5 g	7.5 g	10 g
Acne	1%	3%	8%
Alopecia	1%	0%	1%
Application Site Reaction	5%	3%	4%
Asthenia	0%	3%	1%
Depression	1%	0%	1%
Emotional Lability	0%	3%	3%
Gynecomastia	1%	0%	3%
Headache	4%	3%	0%
Hypertension	3%	0%	3%
Lab Test Abnormal*	6%	5%	3%
Libido Decreased	0%	3%	1%
Nervousness	0%	3%	1%
Pain Breast*	1%	3%	1%
Prostate Disorder**	3%	3%	5%
Testis Disorder	3%	0%	0%

*Lab test abnormal occurred in nine patients with one or more of the following events: elevated hemoglobin or hematocrit, hyperlipidemia, elevated triglycerides, hypokalemia, decreased HDL, elevated glucose, elevated creatinine, or elevated total bilirubin.

**Prostate disorders included five patients with enlarged prostate, one patient with BPH, and one patient with elevated PSA results.

The following adverse events possibly related to the use of AndroGel® occurred in fewer than 1% of patients: anxiety, discolored hair, dizziness, dry skin, hirsutism, impaired urination, paresthesia, penis disorder, peripheral edema, sweating, and vasodilation.

In this clinical trial of AndroGel®, skin reactions at the application were occasionally reported with AndroGel® none was severe enough to require treatment or discontinuation of drug.

Six (4%) patients in this trial had adverse events that led to discontinuation of AndroGel®. These events included the following: cerebral hemorrhage, convulsion (neither of which were considered related to AndroGel® administration), depression, sadness, memory loss, elevated prostate specific antigen and hypertension. No AndroGel® patients discontinued due to skin reactions.

In an uncontrolled pharmacokinetic study of 10 patients had adverse events associated with AndroGel®, these were asthenia and depression in one patient and increased appetite and hyperkinesia in the other. Among 17 patients in clinical studies there was one instance each of acne, edema and benign prostate adenoma associated with a 2.5% testosterone gel formulation applied dermally.

One hundred six (106) patients have received AndroGel® up to 12 months in a long-term follow-up study for patients who completed the controlled clinical trial. The preliminary safety results from this study are consistent with those reported for the controlled clinical trial. Table 2 summarizes those adverse events possibly, probably or definitely related to the use of AndroGel® and reported by at least 1% of the total number of patients during long-term exposure to AndroGel®.

Table 2. Incidence of Adverse Events Possibly, Probably or Definitely Related to the Use of AndroGel® in the Long-Term, Follow-up Study

Adverse Event	Dose of AndroGel®		
	5 g	7.5 g	10 g
Lab Test Abnormal*	4.2%	0.0%	6.3%
Peripheral Edema	1.4%	0.0%	3.1%
Acne	2.8%	0.0%	12.5%
Application Site Reaction	9.7%	10.0%	3.1%
Prostate Disorder**	2.8%	5.0%	18.8%
Urination Impaired	2.8%	0.0%	0.0%

*Lab test abnormal included one patient each with elevated GGTP, elevated hematocrit and hemoglobin, increased bilirubin, worsened hyperlipidemia, decreased HDL, and hypokalemia.

**Prostate disorders included enlarged prostate, elevated results, and in one patient, a new diagnosis of prostate cancer; three patients (one taking 7.5 g daily and two taking 10 g daily) discontinued AndroGel® treatment during the long-term study because of such disorders.

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AndroGel® contains testosterone, a Schedule III controlled substance as defined by the Anabolic Steroids Control Act. Oral ingestion of AndroGel® will not result in clinically significant serum testosterone concentrations due to first-pass metabolism.

OVERDOSAGE

There is one report of acute overdosage by injection of testosterone enanthate: testosterone levels of up to 11,400 ng/dL were implicated in a cerebrovascular accident.

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Do not apply AndroGel® to the genitals.

Serum testosterone levels should be measured approximately 14 days after initiation of therapy to ensure proper dosing. If the serum testosterone concentration is below the normal range, or if the desired clinical response is not achieved, the daily AndroGel® 1% dose may be increased from 5 g to 7.5 g and from 7.5 g to 10 g as instructed by the physician.

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THE COMING AGE OF DVD BURNERS



Drives that can "write" as well as read CDs have become commonplace on desktop computers and even on many laptops. In a year or so, DVD burners could become nearly as widespread. And with software getting better, creating a video disk to show in your living room DVD player could be almost as easy as burning an audio CD for your Discman.

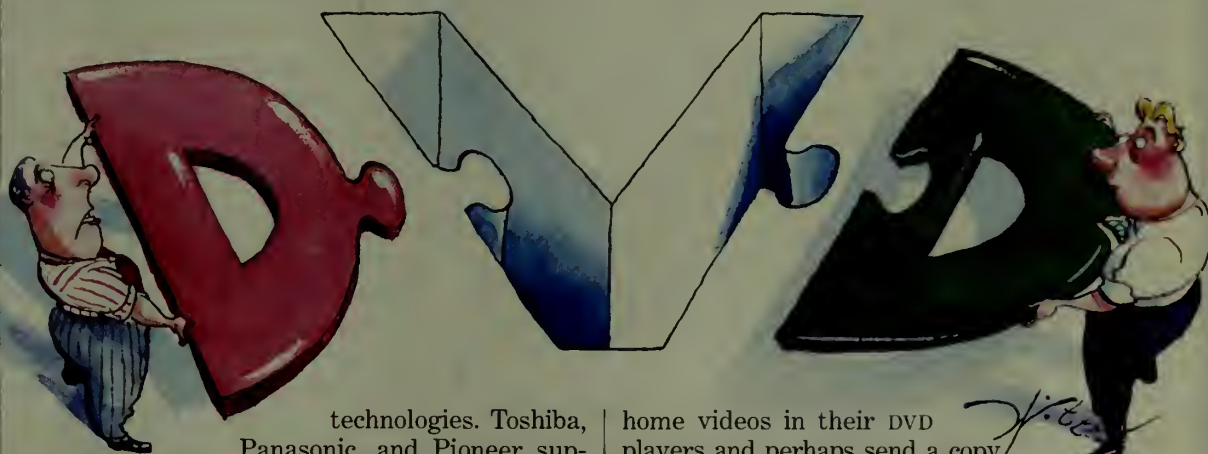
One issue that has stood in the way of wider adoption of recordable DVDs has been a format war, between the "plus" and "minus" camps. One group, led by Hewlett-Packard and Philips, promotes DVD+RW (erasable) and DVD+R (write once)

gues for the DVD-R, with its superior compatibility, being the winner. Apple, which really got consumer DVD burning going, installs only DVD-R drives in Macs.

In addition, most new consumer DVD players and many PC DVD drives can read multiple formats. Sony's \$350 DRU500A drive cuts the Gordian knot by adapting itself to whatever recordable media you put in its tray: +, -, R, or RW.

No matter which format you choose, you will need "authoring" software to create video DVDs. Most drives come with this type of program—with Sonic's MyDVD being the most popular. Other simple programs include Roxio Movie Creator and Ulead Movie Factory. All DVD-equipped Macs come with Apple's iDVD. In general, these programs allow you to create the opening menu page that appears when a DVD is popped into a player. Most also let you transfer video directly from a camcorder to a DVD and create a slide show of still photos on DVD. (Unlike audio CDs, you cannot make copies of commercial DVDs, at least not easily or legally.)

All of these programs are adequate for most consumers who just want to be able to watch



technologies. Toshiba, Panasonic, and Pioneer support the rival DVD-RW and DVD-R standards. While there are technical differences, the real issue is: Which group of companies collects royalties on which patents? The fight has confused consumers, but the fog is lifting. And with falling prices and the availability of better software to create video DVDs, the popularity of DVD burners is rising fast.

All the disks hold 4.7 gigabytes of data, or about two hours of DVD-quality video. And all the DVD burners can create audio or data CDs. DVD+RW disks have the advantage of behaving more like hard drives: You can make changes on one without rewriting the entire disk, an advantage when using the disk to store data. But the DVD-Rs are far more likely to be compatible with existing home DVD players.

The good news is that developments in media and drive technology may resolve the format fight. Media prices are crashing, and, in a pattern similar to what took place in CDs, the erasable versions may become largely irrelevant. With blank DVD-Rs and DVD+Rs available for about \$3 each when bought in 10 packs—and likely to fall below \$1 next year—why reuse a disk? This ar-

home videos in their DVD players and perhaps send a copy to grandma. But more ambitious hobbyists or people working on more complex projects for business can choose from a variety of advanced tools that offer more options. These include more animated menus, alternate soundtracks in multiple languages, and subtitles. The choices, most of which come in "standard" and "pro" flavors, include Pinnacle Systems Impression DVD (\$199-\$399), Ulead DVD Workshop (\$275), and Sonic Dedit (\$250-\$550). Ambitious Mac users can go for Apple's DVD Studio Pro (\$999), which can even produce encrypted, copy-protected DVDs.

When starting to create DVDs, allow yourself plenty of time. For one thing, preparing an hour of video for transfer to a DVD, a job usually done by your video-editing software, can be an overnight job even on a fast PC, especially if you have a lot of titles and effects. Creating menus and dividing your video into the right chapters isn't especially difficult, but it takes a while to do it right, especially at first. The result can be a professional-looking project that will let you show off your video to good advantage on a big TV connected to a DVD player.

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This is part of the Heidrick & Struggles' Leadership Capital series on the topics of governance and leadership. Subsequent articles will focus on the specific skills and challenges for other senior-level management roles and on the critical issues facing corporate leaders today.

FOCUS ON: THE CHIEF INFORMATION OFFICER



Jory Marino
Managing Partner, CIO Practice
Heidrick & Struggles

Of all the changes that have swept over the business landscape in the past 50 years, undoubtedly the most significant is the evolution and expansion of the role of information technology and the impact it has had on running a global company. During this period, IT has migrated from the back office to the executive committee, from cost center to revenue driver, from operational outpost to strategic cornerstone.

The role and the very title of the senior most IT executive has morphed from data processing manager whose primary function was to automate manual processes, to Chief Information Officer responsible for driving technology and often times business strategy. Today, the CIO is expected to conceive and execute the company-wide initiatives that are the basic building blocks of launching a company into market leadership. "Digital dashboards" have emerged in the executive suite in order for corporate chieftains to have an up-to-the-minute read on the financial and operational health of the companies they lead. All this has to happen seamlessly, without failure, and with precious few dollars to get it done.

To say the role of "the keeper of all things electronic" has changed is an understatement of profound proportion. The continued evolution of the CIO role – and the resultant pressures of being a CIO in a global, multidivisional organization – has never been more impacted than it has in the current environment. A CIO's performance depends in part on advances in technological development as well as their ability to deliver against the white-hot competition that impels corporate leaders to extract every last bit of strategic advantage from their organizations' information assets. And if these tasks weren't challenging enough, the CIO role is tested even more as innovation becomes increasingly more difficult in today's constrained economic environment. Today, the CIO in a global organization has become a major league player on the CEO's leadership team, with ample opportunities to shape strategy, set corporate direction, and lead change.

Long after the excesses of the 1990s have been worked off, the era may be most remembered as the decade when corporate leaders recognized that technology is an engine of the business. The challenge facing CIOs today is to apply that insight throughout the organization. It calls for an executive with a rare blend of technical expertise and business acumen, conversant in both HTML and P&L.

Joining this discussion on the evolution of the 21st century chief information officer role are two of the field's most widely respected practitioners: Marv Adams, CIO of Ford Motor Company, and Bank of America Technology and Operations Executive Tim Arnoult. We will also hear from my colleague Kelvin Thompson, who has worked closely with me in building the CIO practice at Heidrick & Struggles. Together we have developed a perspective on the CIO's mandate to deliver innovation – and the equally urgent mandate to do more with less.

In few industries is the sense of urgency so great as in financial services, where systems failures can cost an organization millions. "I didn't even know what a CIO was three years ago," claims Arnoult. But that may be because he was too busy crafting the position to worry much about the title. Under his leadership, information technology at Bank of America has grown from a back-office burden to a significant competitive advantage. "When I first started in banking," he says, "the predecessor to today's CIO was the Senior Vice President of Data Processing. The role was to post transactions to customer accounts and run daily financial statements for the bank. Today, every core process in the company is enabled with technology and the strategic focus is on the use of information to improve customer satisfaction and to gain competitive advantage. Twenty-five years ago technology consisted of mainframes in the back office; today, the customer and bank have the advantage of interacting directly with each other through technology."

As Adams sees it, "The world changed when IBM announced the PC in 1981. As the desktop computer took hold and local area networking took off, the role of the CIO changed dramatically. Overnight, it became one of trying to control the growth of IT and ensuring some consistency in the way IT was implemented across the company. Then came the Internet revolution, and we went from a world with three or four primary providers of technology to one with a seemingly infinite number of software, networking, services and hardware companies. The CIO's priorities have shifted to managing growth and helping the company gain a strategic advantage by investing its IT dollars as effectively as possible."

TODAY'S CIO

Business, and CIOs in particular, have entered a new phase. CIOs now go to work every day with the charter to consolidate

and rationalize the IT explosion of the 1990s, optimizing systems to wring the highest possible returns from the business's technology investments. In practical terms this means effectively managing the tension between the demand to deliver innovation and the need for rigorous expense control. "Technology now dictates how businesses develop, change and evolve," Thompson points out. "That's why corporations can't just settle for someone to run the IT shop. They need innovative technology leaders who look at IT as an asset and continually question what the organization can do with technology to drive up revenue, and not simply just drive out costs. That kind of role will become more and more crucial, and in some cases will permeate into the leadership of the company."

THE CIO'S ROLE IN INNOVATION

Forcing innovation is probably the dot-com era's most worthwhile legacy. The advent of the Internet spurred every business organization to take a new look at its business model. In the financial services industry, where I gained most of my own business experience, new thinking about ways to touch the customer forced companies to consider alternative channels of distribution that leveraged the World Wide Web, and to utilize call centers and traditional brick and mortar models to provide unprecedented levels of customer access. Likewise in other industries, the digital directive has focused management's attention on supply chain issues, logistics, and distribution. As impatient shareholders press for steady productivity improvement, IT departments are being called upon to create efficiencies, drive costs down, and streamline buyer and supplier behaviors. That effort is likely to continue for the next three to five years in just about every industry sector you care to name, as corporations continue to look to technology – and the CIO – for ways to make better business decisions, improve returns, and build connectivity, both within the organization and externally across the length of the value chain.

Today's CIO must now more than ever bring a mixture of technical competence, business savvy, and leadership skills to the table. A thorough grounding in information technology is a prerequisite for the CIO job. "The CIO has to be able to manage suppliers aggressively," Thompson

explains. "If you don't have a background in technology, your ability to manage the people who supply your technology is often limited." Adams believes that today's CIOs are becoming more like investment portfolio managers. "CIOs need to know when to build capabilities internally versus sourcing some of the portfolio to outside suppliers versus building alliances and forging partnerships," he says. "We are sort of back to old-fashioned design. How do you architect the business so that you can derive as much efficiency and value out of the entire portfolio as possible?"

More and more, evidence supports the case for a CIO to possess business acumen as sharp as any operating executive. In very large organizations, the CIO has charge of thousands of people and an annual budget in the billions of dollars. The position requires strong organizational leadership and financial management skills, and it also calls for an ability to balance short-term realities against long-term objectives. "CIOs have become policy-level executives in most companies," says Adams. Strong communication skills are another essential component of this tool kit. "The CIO should be able to make the business case to the technical people and the technical case to the business people," says Arnoult. But most of all, he continues, the CIO needs to be a leader who can build and inspire a high-performing team. "You have to be able to create positive energy and momentum," he says, "particularly when the economy is tough. You also have to attract and retain 'A' players. That is an absolute must."

Adams worries that many organizations are so distracted by short-term pressures that they are losing sight of the importance of cultivating the next

generation of senior technology executives. "At Ford," he says, "we start identifying people at the first layer of supervisory or management responsibility. We give them both educational and experiential development opportunities to create a pipeline of candidates for both corporate as well as divisional level CIOs and heads of IT." Both Arnoult and Adams believe that companies in every industry are going to have to get much more serious about developing technology leaders in the decade to come.

THE FUTURE OF THE CIO

The next wave of CIOs will face demands that earlier generations of technology leaders could not have imagined. Both Adams and Arnoult acknowledge that the new financial reporting requirements imposed by the Sarbanes-Oxley Act add to the pressure on CIOs as well as CFOs and CEOs. Additionally, increased security and risk management pressures following the terrorist attacks on September 11, 2001, combined with the continued demands of the current global economic climate will make the next three to five years that much harder. The impact of these issues cuts across every business concern facing a CIO and adds an extra layer of complexity to decisions involving running a global technology-based organization, from selecting business partners and vendors, to outsourcing operations, to developing strategic alliances.

There are a variety of professional experiences and competencies that can spell success in the CIO position. Adams and Arnoult agree along with us that the CIO of the future will play an ever-increasing role on managing information to drive decision-making, and for providing faster, better and smarter tools for running a global company.

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Jory Marino is Managing Partner of the firm's global CIO Practice. Widely recognized as an authority on leadership and talent within technology and information management functions, Jory's last 15 of 20 years in the executive search business has been focused exclusively on recruiting senior-level technology and operations leaders.

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BY JEFFREY E. GARTEN

WHY BUSH MUST NOT LOSE SIGHT OF LATIN AMERICA



HOT SPOTS:
The U.S. has enormous political and economic interests in the region, where crisis after crisis is brewing—and al Qaeda is starting to operate

Jeffrey E. Garten is dean of the Yale School of Management and author of *The Politics of Fortune: A New Agenda for Business Leaders* (jeffrey.garten@yale.edu).

It's not surprising that an Administration preoccupied with Iraq and terrorism has had little time for other crises. But the U.S. could be deeply engaged in fighting fanatics for years to come, and it is essential that other serious problems not fall off Washington's high-priority agenda. Case in point: Latin America.

Consider Mexico. Just days before the September 11 attacks, Presidents George W. Bush and Vicente Fox were working toward a deal to resolve the status of the 3.5 million illegal Mexican workers in the U.S. But after September 11, progress stopped. As a result, millions of Mexicans still cross the border illegally, many subjected to physical abuse when caught. Undocumented workers who get into the U.S. find themselves at greater than ever risk because of homeland-security concerns. All this is happening even as America needs productive Mexican workers. Moreover, labor issues have chilled cooperation between the U.S. and Mexico on trade, environmental protection, illegal narcotics traffic, and sharing of energy and water.

Brazil's financial situation is a potential crisis as well. The country's \$290 billion public debt is an astronomical 60% of gross domestic product. Foreign bank lending and investment in the Brazilian stock markets is seizing up. If domestic interest rates continue to rise, driving up debt-service costs, a debt default early next year is possible. That would be bad news for some major U.S. banks. Citigroup's exposure to Brazil is 13.5% of its equity.

Argentina is in political chaos. Its economy will shrink this year by at least 11%, and it has defaulted on more than \$100 billion of debt to commercial banks and on \$800 million to one of its lenders of last resort, the World Bank. In Venezuela, violent strikes and a politically isolated President have made the country nearly ungovernable as its economy sinks into ever deeper recession. Colombia is staring into a tragic abyss as its narco-guerrilla gangs spread from the countryside to the cities.

The one major hemispheric U.S. initiative, a free-trade agreement for all the Americas, is moving at a glacial pace. One reason: Latin American nations, led by Brazil, wonder what's in it for them, since Washington continues to block their critical exports with tariffs and subsidies.

For the U.S., the cost of these escalating problems could be high. About 20% of all U.S. exports go to Latin America, vs. 16% to developing nations in East Asia. Because of economic contraction in the Southern Hemisphere, the

U.S. merchandise deficit with the region rose by over 31% in the first eight months of this year. The stock of U.S. direct investment in Latin America is worth about \$163 billion, or 30% higher than in East Asia (excluding Japan). U.S. companies, from AOL Time Warner Inc. to General Motors Corp., can't be sanguine about the future of their investments.

The stakes are high. At a time of slow global economic growth, financial crises in Brazil and Argentina could spill over into other emerging markets. From Mexico City to Buenos Aires, growing skepticism about the benefits of globalization could bring a reprise of failed populist and protectionist policies.

Economic and political decay could also undermine hemispheric security. Investigative reporter Jeffrey Goldberg, writing in *The New Yorker*, has recently documented that al Qaeda, Hamas, and Hezbollah are present in South America. Cooperation between the expanding network of narcotics traffickers and terrorists is now increasingly possible.

Washington should get in front of this regional crisis. It should reinject life into NAFTA, first with an agreement on Mexican labor in the U.S. then with comprehensive cooperation on border security that expands rather than disrupts trade. The two countries ought to increase investment in transportation systems to boost commerce throughout North America.

The U.S. should befriend the new Brazilian President, Luiz Inácio Lula da Silva, when he comes to the White House on Dec. 10. Washington needs to be ready to lean on the International Monetary Fund to provide more assistance. To get hemispheric trade negotiations moving faster and to encourage Brazil to support them, President George W. Bush could also signal his willingness to address U.S. trade barriers to Brazilian exports such as steel, citrus, and sugar. Washington could also mount a high-profile trade mission to Rio de Janeiro and São Paulo to build stronger commercial links between the two nations.

Of course, it is essential for Latin American governments to strengthen their public-sector management and pursue sound economic policies. On these scores, there is, indeed, much to do. But these countries are natural economic and security partners for the U.S., and they deserve serious attention and help from Uncle Sam. As a new year beckons, Washington should demonstrate a renewed and deeper commitment to the region.

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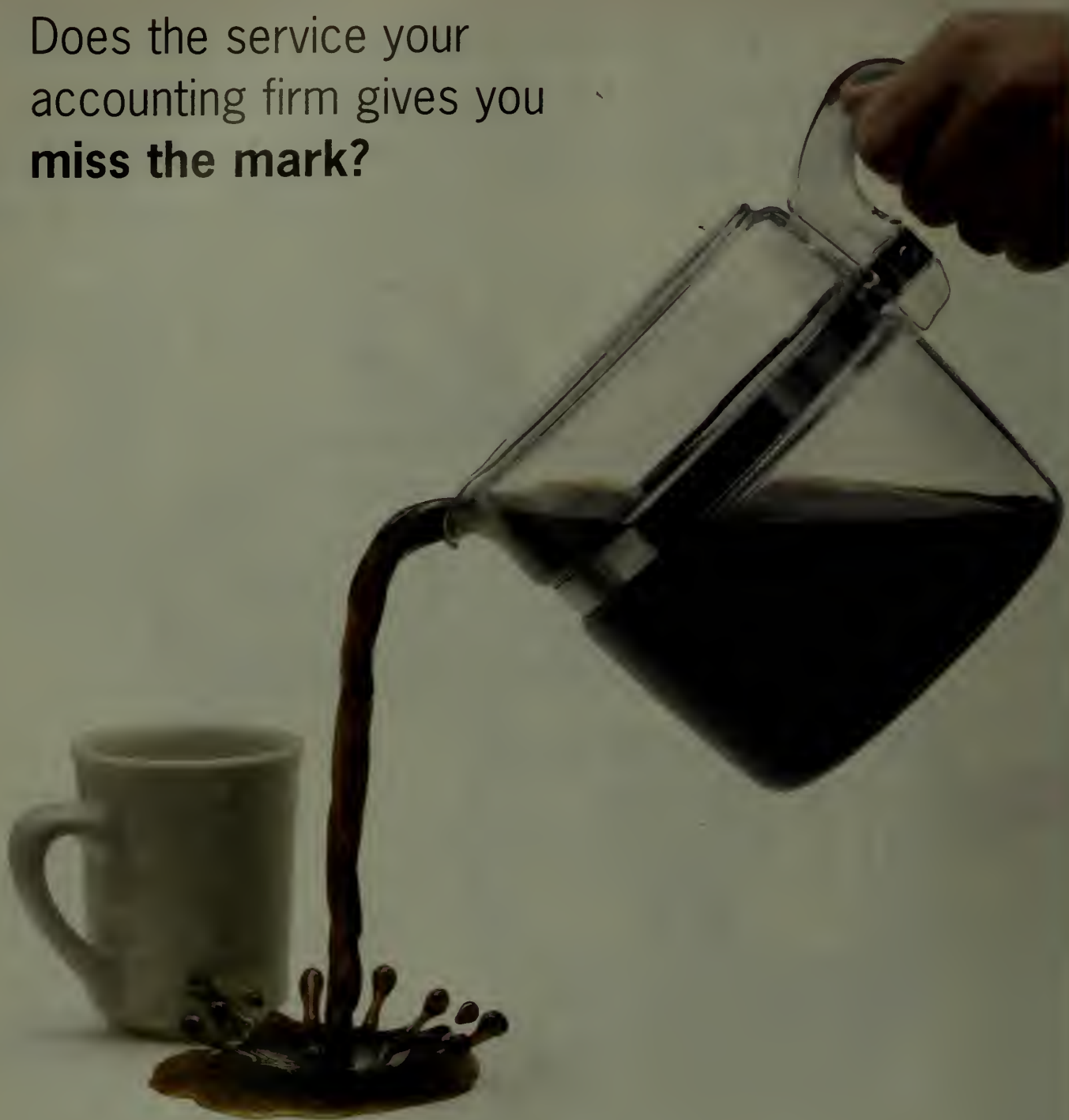
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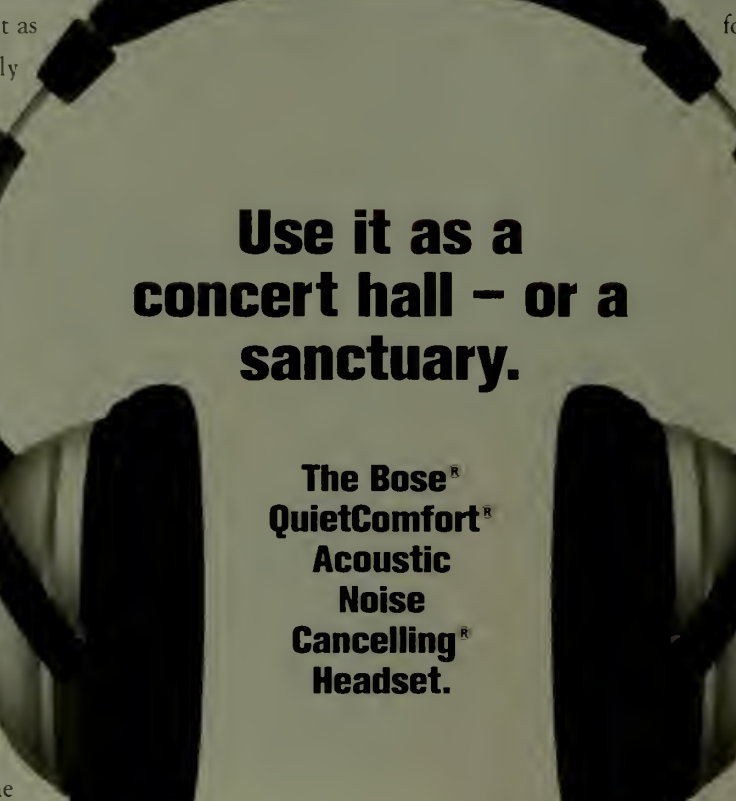
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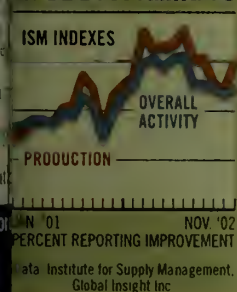
JAMES C. COOPER & KATHLEEN MADIGAN

THE WINTER LANDSCAPE ISN'T AS BLEAK AS IT LOOKS

tough quarter, yes—but consumers look set to lead stronger growth

U.S. ECONOMY When the books are closed on 2002, the economy's growth pattern will look like the squiggles of an EKG, with peaks of 4% to 5% tucked between rates of 1% to 2%. The fourth quarter will be one of the year's low points, with growth struggling to come in at half the third quarter's 4% clip. But the patient remains healthy, and the reading is set to spike up again next quarter. What much seems clear from some recent upbeat data. In October, consumer spending bested previous expectations, as did the level of new orders for capital goods. Homebuilding remains resilient. The industrial sector is still struggling but showing signs of recovery from its summer slump (chart). And in November, the stock market managed to hold on to its October gains, while a clear downtrend in new filings for employment benefits raises hopes that massive layoffs are a thing of the past and that businesses will start hiring again in coming months.

THE FACTORY SLUMP MAY BE BOTTOMING OUT



Nevertheless, while the economy heads into 2003 on a solid if unspectacular trend of about 3% growth, it will also begin the New Year much as it started 2002: dogged by uncertainty. Fear of the unknown, so palpable just after the September 11 terrorist attacks, has waned somewhat, as have the shocks of corporate scandals. But the question marks of a possible war in Iraq and how economic policy will play out in the new Republican-led Senate will weigh heavily on any assessment of the outlook. Despite recent upbeat signs, households are dealing with the year's losses in the stock market, which is down about 20% year to date, and businesses are still struggling with low utilization rates. However, the solid performance of key fundamentals, including productivity, real household income, and corporate profits, against a backdrop of stimulus from low interest rates and improving financial conditions, are giving the economy the momentum it needs to take real gross domestic product growth to a higher plane next year.

THE CHIEF GUIDE for the economy's strength in early 2003 will be—as it has been all year—consumer spending. That's why October's stronger-than-expected

0.2% increase in real outlays is so encouraging. Outside of the expected drop in car buying, consumer spending posted solid gains. Outlays for durable goods, which include cars, plunged 0.9%, but spending on nondurable items, such as food and clothing, rose 0.5%, the largest increase in nine months; and service purchases, about half of all spending, posted a 0.2% advance.

The problem for fourth-quarter economic growth is that household outlays—two-thirds of GDP—began the quarter in a deep hole. Car sales, which averaged an annual rate of 17.6 million in the third quarter due to generous sales incentives, fell to 15.3 million in October and picked up to 16 million in November. As a result, total consumer spending began the quarter 0.9% below its third-quarter level. Even with solid increases in November and December, consumer spending will post little growth this quarter, compared with the previous quarter.

The strong performance, however, of nonauto spending in October and upbeat reports on post-Thanksgiving sales, both at brick-and-mortar stores and on the Internet, suggest that consumers are still in a buying mood. Clearly, households have plenty going for them. In addition to the stock market rally, cash from record refinancing activity will fuel spending this quarter and next. Also, energy prices have declined.

Most important, net hiring gains since April have lifted the yearly growth rate in wages and salaries to 3% in October, from no growth earlier in the year (chart). After adjustments for inflation and taxes, real household income has grown at an annual rate of 3% during the past six months, while overall spending has risen only 1.9%. Consumers clearly have the ability to spend at a faster clip, and that stronger trend will reassert itself in coming months.

BUT CONSUMERS HAVE BEEN DOING their part throughout this recovery. The sticking point in the outlook is the unwillingness of business to spend on new equipment or facilities or to boost output enough that more workers are needed. The caught-in-the-headlights paralysis from the year's uncertainties is keeping many companies from moving forward, but recent data

HOUSEHOLD INCOME WILL SUPPORT CONSUMERS



Business Outlook

at least suggest that companies are no longer slashing production schedules or capital budgets as they were throughout 2001 or earlier this year.

The latest reports from the Institute for Supply Management (ISM) confirm that the service sector is expanding at a faster clip and that manufacturing has all but stopped deteriorating. The Business Activity Index for nonmanufacturers jumped from 53.1% in October to 57.4% in November, while the ISM's index for manufacturers edged up from 48.5% to 49.2%, just below the 50% mark, which divides contraction and expansion. Industries boosted production last month, and delivery times continued to lengthen, but the factory indexes covering new orders and exports weakened. One key reason that businesses are not showing more momentum, said the ISM, was the Iraq situation: "Members felt the uncertainty is a deterrent to business."

CAPITAL-GOODS ORDERS, long seen as a proxy for business confidence, also support the idea that businesses remain hesitant about the future. Orders for nondefense capital goods excluding aircraft jumped 5.5% in October, nearly wiping out the declines of the previous two months. But nonaircraft capital-goods orders, always a volatile series, have been especially bouncy this year. In general, the trend in orders has been decidedly flat in 2002 (chart).

Companies are holding off from buying much new

equipment for several reasons. First, operating rates at many industrial companies are extremely low—factories, on average, are only using 73.5% of their capacity. So companies have little need to expand their facilities. Second, companies are waiting to see if new Congress passes tax incentives on capital investments, which would make equipment buying cheaper and if Washington extends credits for research and development.

Third, strong productivity is allowing companies to boost output without adding one lick of new machinery. The Labor Dept.'s revised data show output per hour worked in the third quarter grew at an annual rate of 5.1%, up from the original estimate of 4%, leading to growth of 5.6% over the past year—the strongest such pace in 30 years.

Mostly, though, businesses are still unconvinced demand will remain strong enough to justify boosting their capital budgets and moving ahead with new projects. It will probably take solid, back-to-back quarterly gains in real GDP to persuade businesses to shake the paralysis and start spending and hiring. But don't expect to hear that tale this quarter. That's a 2003 story.



BRAZIL

A PERILOUS COURSE FOR LULA

Economists are holding their breath as they make their 2003 forecasts for Brazil. In general, they are betting that the new left-leaning government of President-elect Luiz Inácio Lula da Silva will be able to juggle the social agenda on which Lula was elected with the policy needs of a heavily indebted economy—without an Argentine-style collapse.

It won't be easy, though. Lula, who takes office on Jan. 1, inherits a net public debt of about \$250 billion, or some 60% of gross domestic product. At the same time, the currency has lost some 35% of its value this year, primarily over worries that Lula's socialist roots could lead to

debt default, capital controls, or general economic mismanagement.

The weak currency is helping to push inflation to an expected 10% both this year and next, the highest rate since 1995. All this leaves little room for Lula to develop his election promises to cut joblessness, improve income equality and education, and revive the economy.

Since September, the central bank has raised interest rates from 18% to 22% to combat inflation, with another hike expected in December. As a consequence, growth is set to slow, and the 8.5% jobless rate will rise further. After growth of 1.4% in 2001, economists expect a 0.5% gain in 2002

and little if any headway in 2003.

Investors remain wary, but market-friendly talk from Lula's transition team, upbeat comments from International Monetary Fund officials, and a favorable reading on third-quarter GDP have buoyed the currency in recent weeks. The new administration has pledged to maintain the previous government's policies of inflation targeting, a floating exchange rate, and a surplus primary budget, which excludes debt service.

The chief focus for the market in coming weeks will be Lula's choice of Finance Minister and central bank president. Crucial decisions early next year by Lula and his economic team on the 2003 budget, the IMF's loan program, and central bank independence will shape Brazil's economy both next year and beyond.





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INCHING TOWARD TAX REFORM

President Bush wants big tax changes—but in small increments

In 1986, Ronald Reagan scored a coup by persuading Congress to adopt the most wide-ranging reform of the U.S. tax code in 30 years. Ever since, conservatives have pined for Tax Reform II. Now, George W. Bush may be about to grant their wish. But while the President is an avid student of all things Reaganesque, he may adopt a fundamentally different strategy for the tricky business of muscling tax reforms through Congress. Instead of pushing for change in one bold flourish, Bush may opt for an incremental approach.

In his January State of the Union address, the President is expected to kick off his campaign against the tax code, blasting its complexity and unfairness. Yet he's likely to avoid offering a specific reform blueprint. Current White House thinking, sources tell *BusinessWeek*, is to cut reform proposals into five digestible chunks. Some could

be passed as soon as next year.

None of these tax proposals would be dramatic on its own. They will probably be proposed under the rubric of tax cuts geared toward giving the economy a lift. But cutting taxes isn't the Administration's only goal. Taken together, the proposals also add up to a broad if "stealthy" reform package aimed at easing the current revenue code's bias toward taxing savings and investment rather than consumption. "You'll never be able to do Big Bang tax reform," says Ernest S. Christian, a corporate lobbyist and veteran of Washington's tax wars. "But you can do it in five easy pieces."

Although aides say Bush has not yet settled on details, his advisers are examining several distinct elements that could be rolled out next year: reducing taxes on corporate dividends, slashing individual tax rates, increasing first-year write-offs for business investment, restructuring taxation of foreign income of U.S. companies, and expanding tax-free savings accounts such as individual retirement accounts.

Bush has always been attracted to sweeping reform goals, and these changes could provide a much-needed jolt to his domestic agenda as he heads into the second half of his term. Depending on economic conditions early next year, they may be marketed as tax simplification,

or billed as an integral part of Bush's "growth and jobs" agenda—ideas meant to give dormant capital investment a kick. And White House pols are thrilled. They know there's nothing like juicy cuts and talk of simplifying tax laws to fire up the GOP base and, perhaps, pull swing voters.

While the White House will argue that its mini-reforms will produce an economic boom, evidence is thin. Alan Auerbach, a tax economist at the University of California at Berkeley, figures that a major restructuring, such as a flat tax, would boost national output by less than 10% over 15 to 20 years. The more modest changes Bush is considering would have a much smaller impact. "Something is better than nothing," says Auerbach. "But it's hard to imagine the effects would be very large."

Still, moving in stages has big advantages. It gives the White House flexibility about the cost and structure of each piece of the plan, allowing it to scale back proposals if the budget deficit continues to worsen. That's a major concern of Treasury Secretary Paul H. O'Neill. It allows Bush to gather coalitions for

FIVE EASY PIECES

The Bush Administration is considering several ways of lowering the taxes on savings and investment:

EASE DOUBLE TAXATION OF CORPORATE DIVIDENDS

► For starters, Bush may move to exclude, say, 20% of corporate payouts from taxation.

INCREASE THE EXPENSING OF BUSINESS INVESTMENT

► The 2002 stimulus package increased first-year write-offs for capital equipment by 30%. Bush may make them more generous.

REDUCE TAX RATES

► The 2001 tax cuts gradually reduced marginal rates through 2006. Bush may accelerate all cuts to next year and set the stage for further rate reductions.

MAKE SAVINGS TAX-FREE

► Bush may reduce taxes on savings by increasing contribution limits to IRAs and 401(k) plans, making such plans available to more workers.



the popular ideas while allowing more time to build support for others. Most important, the bite-size strategy may finally mean a truce among conservatives who have argued for years whether to adopt a flat income tax or a national sales tax. "This is a political struggle, not a contest to see who can come up with the most economically optimal system," says Stephen Moore, president of the Club for Growth, a group that funds supply-side candidates. "The focus now is on something you can get the votes for."

Some longtime reformers are skeptical about the cuts' bringing real reform. Urban Institute senior fellow Rudolph G. Penner, who worked on tax restructuring in the '90s, doubts that the incremental strategy will eliminate tax loopholes, a key to any serious reform. "It's almost impossible to get to a pure tax step-by-small-step," he says.

One reason: Slashing rates much below the levels approved in the 2001 tax cut will be tough. Early on, Bush will try to accelerate and make permanent those '01 rate cuts. But with deficits expected to continue in the \$200 billion range, additional rate reductions would have to be offset by killing popular tax breaks, such as the mortgage-interest deduction and ending the tax-exemption for employer-paid health insurance. That's unlikely: Taking on such sacred cows would be political suicide.

Ideally, the Administration would

RESTRUCTURE INTERNATIONAL TAXES

► Using a World Trade Organization ruling that tax breaks for U.S. exporters are illegal, the White House is considering taxing income earned by U.S. companies overseas only when it is distributed to U.S. shareholders.

shift the tax system closer to one based largely on taxing consumption rather than income. Businesses would pay no tax on reinvested earnings, and individuals would pay no tax on income until they spend it. That would result in two broad changes: Taxes would be cut on savings and investment, and income would be taxed only once. Today, some income, such as employer-provided health-care benefits, is not taxed at all. But investment income, such as dividends, is taxed twice: First corporations are taxed, then shareholders.

Problem is, such shifts would be ex-

pensive. Eliminating the double tax on dividends, for example, would cost more than \$50 billion a year. So Bush aides are exploring an alternative: Let investors avoid tax on, say, 20% of payouts next year, then gradually increase the share of tax-free dividends. Will that help much? Salomon Smith Barney chief economist Robert DiClemente figures that completely repealing the double tax on dividends would boost the stock market by doubling dividend yields from the current 1.7%. The more modest Bush plan would provide much less of a kick. "The effects are positive, but not monumental," he says.

For business, tax nirvana would be allowing companies to deduct the cost of plant and equipment in the year it is purchased—rather than depreciating it over time. That dream is closer to reality. Earlier this year, Congress agreed to an extra 30% first-write-off, but only for equipment bought before Sept. 11, 2004. The White House is considering upping that first-write-off bonus to, say, 50%, and extending time during which it could be taken.

Such a plan should boost capital investment and already has strong business support. Chris Varvares, president of St. Louis consultants Macroeconomic



SHRINKING THE PIE

Daniels is bracing for a fight with senators reluctant to surrender the pork

What's more, the Administration said on Nov. 14 that it would proceed with plans to cut up to 850,000 federal jobs in the private sector, from manufacturing to computer services.

Presidents since Richard Nixon have talked of downsizing the bureaucracy and reducing spending. But Bush is likely to succeed where others failed. Riding high in the polls and basking in the glow of his election, the President has extraordinary leverage on Capitol Hill. Moreover, he can use the threat of terrorism to justify any sacrifice, as he did

in 2001, when he denied federal workers in high-cost communities an 18.6% pay raise. "He's become the budgetary colossus," says Robert Bixby, executive director of the Congressional Budget Coalition, a deficit-watchdog group.

Certainly he's wasting no time in pushing out the austerity message. Budget director Daniels in late November began a round of meetings with Cabinet departments to discuss the President's order to cut each agency's total budget at current levels. Cuts must offset any additional security spending, they are being told.

While domestic spending takes a hit, the Pentagon could see its \$379 billion budget soar to

BATTLE THE BUDGET

Cuts in these areas will make room for increases in defense and security

FOR DOMESTIC PROGRAMS, THE BUCKS STOP HERE

Bill Clinton may have declared in 1995 that the era of Big Government was over, but Congress didn't take the hint. Over the next six years, lawmakers increased spending on domestic discretionary programs—from roads to police to schools—by 28%, or nearly twice the rate of inflation.

That spending spree is about to come to a screeching halt. The federal deficit, now at \$159 billion, could top \$200 billion in the fiscal year that began Oct. 1. So to free up money in a \$2 trillion budget for its top priorities—a military buildup, homeland security, and tax

cuts—the Bush Administration and the new Republican majority on Capitol Hill are mapping out an aggressive strategy to squeeze domestic programs. "This year, the President was the only stopper against excess spending," says White House budget director Mitch Daniels. "Now, he has more allies."

The result will be something that was unnecessary during the boom years of the late '90s: spending freezes or cuts for some programs, such as winter heating subsidies for low-income Americans, and smaller increases than promised for others, such as education.

visers, figures full expensing would the cost of capital by 8% for comers and software, say. But an incremental expansion such as Bush is considering might trim costs by only 1% or less. "You don't get much," he says. "But it doesn't cost much."

Bush may push a similar step-by-step plan for IRAs and 401(k)s. Today, people can put only \$3,000 a year into IRAs and \$11,000 in 401(k)s. In addition, there are limits on how the funds may be used and strict rules about withdrawal. While many in the Administration would like to allow all investment income to go untaxed, that's far beyond what's politically doable today. Instead, the Bush administration will try to slowly expand existing tax-free savings plans by making it

easier to contribute or withdraw funds.

The key battle will be over how the changes are structured. Simply raising contribution limits might boost private savings, as reformers claim. But it would aid only high-income workers who already max out on annual payments to their retirement plans. Thus, Democrats want to target benefits to low- and middle-income workers. Says Brookings Institution economist Peter Orszag: "Democrats are worried about a grandmother with \$75,000 in her IRA, not some guy with \$4 million."

The most complex initiative the Administration may propose involves international taxes. Earlier this year, the World Trade Organization ruled that the U.S. system of tax subsidies for

exports is illegal—and Bush aides saw a chance to restructure taxes on foreign income of U.S. companies. One option under consideration: allowing companies to avoid taxes until their foreign profits are returned to the U.S.

Given the difficulty of fundamental change to the tax code, stealth reform will still prove a political challenge for the White House. In 1986, Reagan achieved what many consider a miracle. Bush, whose domestic policy is more cautious than his mentor's, won't try to pull off the sort of fiscal Hail Mary play that Reagan did in 1986. But in his slower, more disciplined way, he may make substantial progress on an issue that many had given up for dead.

By Howard Gleckman in Washington

an \$400 billion next year if the president goes to war with Iraq. As a result, federal spending will continue to grow even as social programs shrink. To centralize control over spending, Republican leaders are taking steps to reduce the independence of appropriations subcommittee chairmen, who are generally fierce defenders of their programs. For the first time, the House appropriators will be chosen by seniority, not by seniority. And House members may be axed if they send a bill to the floor without getting approval from above. "That's a clear sign they can't freelance anymore," says N. J. Pitney Jr., a political scientist at Claremont McKenna College. However, the narrowly divided—and conservative—Senate will be hard to control. A key concern is new Appropriations Committee Chairman Ted Stevens (R-Alaska), who tops the Senate list of pork-barrel spenders, according to the conservative Citizens for Government Waste. Administration officials realize there will be a clash with the Senate in '03. "The dictionary I feel safe in making is that I will have difficulties," says Stevens. But the leadership will keep pushing. "They're going to whine and try to make their case [on national spending]," predicts one administration adviser. "But they're also of the opinion that they want to contribute to the success of the President and

the Republican majority."

The White House is eager to test its clout. One possibility: a vote shortly after the new Congress convenes, on Jan. 7, to freeze most 2003 spending at 2002 levels. That, says a Bush strategist, "will set the tone."

The President signaled the tough new line in August, when he refused to spend \$5.1 billion of emergency appropriations approved by lawmakers for programs including nuclear plant safety and veterans' health care. Bigger cuts are certain in '03. Congress is unlikely to fully fund the sweeping reforms designed to improve public schools. And the White House may withhold new funding that the strapped Securities & Exchange Commission needs to hire additional lawyers and accountants and increase pay.

The biggest potential budget-buster is the 2003 Transportation Act. In the past, the highway bill has been a bipartisan porkfest for lawmakers who want to bring money for roads, bridges, and public transit to their districts. Bush is caught between his hard line on spend-

ing and advisers trying to improve his standing with unions, who see the bill as a job-creator. In the end, Congress-watchers predict Bush will allow modest hikes.

Democrats are hoping to generate a backlash against Bush for blocking funds for programs that aid the poor, the elderly, and veter-

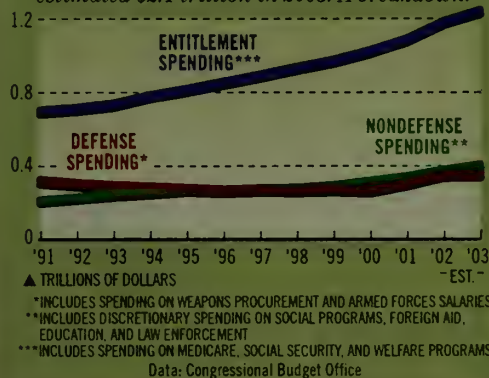
ans. Critics say the Bush budget strategy is little more than political theater designed to distract attention from tax cuts that will drain trillions from the treasury. "It's largely a snare and a delusion to mask their fiscal irresponsibility," fumes outgoing Senate Budget Committee Chairman Kent Conrad (D-N.D.). "None of this adds up."

As passionate as Conrad may be, he will soon be an ex-chairman with little ability to stop Bush's budget brinkmanship. And while the federal deficit seems likely to balloon, that's something this President can live with. He has other, higher priorities: winning the war on terrorism and putting domestic programs on an extended diet.

By Richard S. Dunham in Washington

THE BALLOONING BUDGET

The U.S. budget, including interest payments, has grown from \$1.3 trillion in 1991 to an estimated \$2.1 trillion in 2003. A breakdown:



EDUCATION

President and Congress have agreed on reforms in education. But the White House may not fully fund them in 2003.

FEDERAL WORKERS

The Administration is getting ready for a clash with government unions by pushing to outsource 850,000 federal jobs.

JOB TRAINING

Republicans want to consolidate federal job-training programs and, Democrats charge, services to the unemployed.

SEC

The GOP and Bush may withhold new SEC funds for more investigators and much-needed pay increases.

TRANSPORTATION

Budget Director Daniels is likely to spar with lawmakers who want more money for roads, bridges, and public transit.

REGULATION

WILL OVERSEAS BOARDS PLAY BY AMERICAN RULES?

Sarbanes-Oxley riles many global companies with U.S.-listed stocks

Ever since President George W. Bush signed the Sarbanes-Oxley Act into law on July 30, it has caused a furor in Europe and Asia. Aimed at cleaning up corporate governance and accounting in the U.S., some provisions of Sarbanes-Oxley conflict with the laws of other countries. That could pose big problems for non-U.S. companies listed on the New York Stock Exchange and other U.S. markets. Here's a guide to the issues—and the likely outcome:

What's at risk if no compromise is found?

Plenty. Foreign companies that trade on U.S. exchanges could delist, while those considering a U.S. listing might wait. At the NYSE, there are 470 non-U.S. companies listed, with a combined global market cap of \$3.8 trillion, or about 30% of the total exchange. If even a fraction of those companies bolted, the impact would be heavy. U.S. investors would have more difficulty investing in foreign companies, and the companies that delist would lose easy access to American capital.

What is the likelihood that such an exodus may occur?

Low, say most foreign execs. But they stress that it's not out of the question. Already, Porsche in Germany and Daiwa Securities Group Inc. in Japan have delayed listing on the New York Stock Exchange as a result of Sarbanes-Oxley. Warns SAP finance director Christoph Hütten: "If the SEC doesn't give an exemption to German companies, we would all have a problem."

Why is Sarbanes-Oxley such a problem for foreign companies?

Under the law, CEOs are required to vouch for financial statements, boards must have audit committees drawn from independent directors, and companies can no longer make loans to corporate di-

rectors. All of that conflicts with some other countries' rules and customs.

Where do conflicts exist with new U.S. corporate-governance regs?

Mostly in Germany, where supervisory board audit committees must include employee representatives; by definition, they aren't independent. "That's what finally made us decide no, this [U.S. listing] doesn't make sense," says Porsche CEO Wendelin Wiedeking.

How big a headache for foreign companies are the new U.S. rules?

Independent audit committees are almost unheard of at many European and Asian companies. In Europe and Japan, outside auditors are chosen by share-

holders, not the audit panel, as required by Sarbanes-Oxley. That may have played a part in Daiwa's decision to postpone its NYSE listing.

Do all non-U.S. companies have a problem with Sarbanes-Oxley?

No. TPG, a Dutch package-delivery outfit, and Siemens, the German electronics concern, have already taken steps to comply. French-Italian chipmaker STMicroelectronics says it will have little difficulty abiding by U.S. law, as will Dutch banking giant ING and Japanese carmaker Toyota, and British-Dutch packaged-goods maker Unilever.

What do foreign companies want?

Lobbyists and government officials representing Japanese and German businesses would like to see the law amended to exempt their companies. But with public sentiment against corporate shenanigans still running high in the U.S., congressional leaders don't have much appetite for softening Sarbanes-Oxley. So overseas businesses are trying to show that their practices protect U.S. shareholders just as well as the Americans. Says Fujio Mitarai, CEO of Canon Inc.: "I don't think that our management structures and in-house controls have to match U.S. standards."

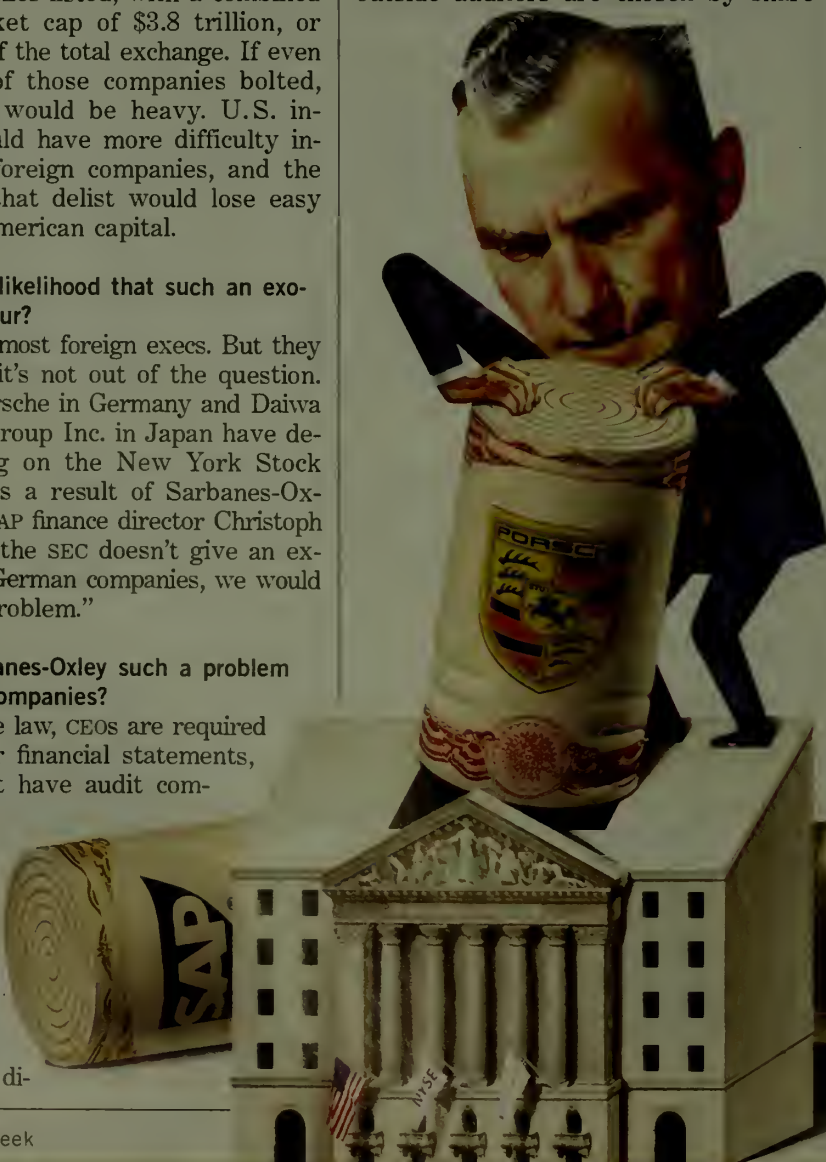
Can the SEC help?

Yes. It's using its authority to interpret legislative language and ease the burden on foreign companies. The SEC has already proposed two types of exemptions: The ban on insider trading during 401(k) blackout periods would apply to foreign companies only when the blackout affects U.S. employees, and restrictions on use of pro forma financial figures wouldn't be enforced when foreign companies are communicating with their non-U.S. shareholders. Sarbanes-Oxley also gives the SEC some wiggle room to interpret how "independent" directors must be to serve on audit committees. The SEC has no authority over the ban on corporate loans to execs.

In the end, the companies may need to adapt to the new ways of Washington if they are to maintain access to the rich capital markets in the U.S.

Compared with the alternative, that may be a small price to pay.

By Lori Lavelle in New York, with Michael McNamee in Washington and bureau reports





Is your enterprise network on the right track?

Truth is, your enterprise network runs on multiple tracks. Hopefully headed in the same direction. You know where you need to go – local to global, legacy to leading edge, separate systems to an integrated platform.

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MOVING BUSINESS FORWARD

COMMENTARY

By David Welch

SLOW DOWN THOSE ASSEMBLY LINES



The auto industry seems to be entering the slow lane. Even fat rebates and 0% financing deals couldn't prop up November sales. Auto makers sold 13% fewer vehicles in the U.S. last month than a year earlier, and the Big Three collectively suffered an 18% drop. As a result, the industry's annualized sales rate skidded to about 16 million vehicles in November—down from 18.6 million as recently as August.

So with sales softening, are carmakers starting to think about trimming capacity? Hardly. In fact, they're doing quite the opposite. Apart from Ford Motor Co., which has announced fourth-quarter production cuts of 2.6%, auto maker after auto maker is ramping up production in the U.S. to gain share. The inescapable conclusion: The battle for the hearts and wallets of American car buyers is about to get a lot nastier, and even strong players like Honda Motor Co. and Toyota Motor Corp. could get pinched. Pricing will continue to fall, and margins will be squeezed for most. Says Sanford C. Bernstein & Co. analyst Scott Hill: "Everyone thinks they're going to steal more market share than they will."

Consider that Detroit's carmakers and their foreign rivals with stateside plants have announced plans

to add enough capacity to build another 1.5 million vehicles by mid-decade. That's in addition to the 20 million

vehicles that can already be built in the U.S., not to mention about 3 million cars and trucks shipped here each year from European and Asian plants. Add it up, and more than 24 million vehicles will be built annually for the U.S. market—40% more than the 17.4 million cars the industry sold in 2000, its best year. Even if foreign carmakers cut imports when their new U.S. production comes on line, that's still far more cars than U.S. buyers can handle.

How will the coming demolition derby play out? With the Japanese and Koreans ramping up production the most, it's tempting to predict that imports will eat Detroit's lunch. But the situation isn't so clear-cut. Although Ford and Chrysler will likely suffer, General Motors Corp. may emerge stronger. And while Honda and Toyota are expected to gain share, Nissan and Hyundai are taking a big gamble. Says GM Vice-Chairman Robert A. Lutz:

"Someone is going to be disappointed."

Ford will be hurt the most. Its sales are down 11% this year, more than any other big auto maker. And relief won't come until at least 2004, when the company plans to replace its aging Taurus sedan with the first of a quartet of crossover sport-utility vehicles. That's

why Ford has targeted five plant possible closure in the next few years.

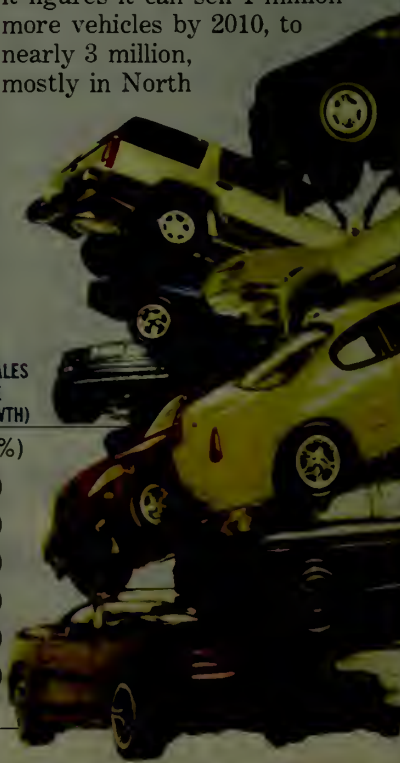
Nissan Motor Co. is headed in another direction. Emboldened by a impressive comeback, Japan's No. 3 maker has built a \$1.4 billion plant in Mississippi. After it opens in 2003, the factory actually will produce 400,000 vehicles a year, more than doubling Nissan's North American capacity. The plant will mostly build full-sized pickups and SUVs, a gamble given that the Japanese have had a tough time competing in those Detroit-dominated markets.



Also facing long odds are the third-tier players who have been competing mostly on price. Consider Hyundai Group, which is building an Alabama plant to crank out 300,000 Sonata sedans

and Santa Fe SUVs a year. That number for Hyundai, which sells 380,000 vehicles today, would need to boost sales by 40% to sell out its new plant.

Detroit's big players won't necessarily have it any easier. Although Chrysler's sales are down 3% this year, it figures it can sell 1 million more vehicles by 2010, to nearly 3 million, mostly in North America.



Tailpipe Dream?

One auto maker after another is planning big production and sales gains in the U.S.

* Includes sales to Canada and Mexico
Data: Company reports

	2002 SALES (EST.)	PROJECTED NEW SALES BY MID-DECADE (PERCENTAGE GROWTH)
NISSAN	750,000	300,000* (40%)
TOYOTA	1,750,000	300,000 (17)
CHEVROLET	2,700,000	300,000 (11)
MITSUBISHI	350,000	250,000* (71)
SATURN	260,000	240,000 (92)
HONDA	1,200,000	200,000 (16)
HYUNDAI	390,000	110,000 (38)

1. The company is rolling out a new passenger cars, ranging from SUVs to all-wheel and rear-drive cars that appeal to sporty. Chrysler will try to grab share with aggressive pricing, since it can lose new models on the cheap by parts and engines from partners like Ford and Mercedes-Benz. The idea is to snag car-market share from imports. Will it work? A decision will be made. Detroit has routinely failed to keep foreign brands with its autos. In 1997, the Big Three's share of the passenger-car market has tumbled to about 60.6%. And while all three are best buyers, Chrysler has the best position in the business: its larger vehicles make up just a quarter of sales.

One reason the Big Three could be stealing buyers from one another, is that their foreign rivals. GM may have the advantage: With its plants in Japan, Honda-level efficiency, GM has the financial muscle to develop new cars with aggressive incentives to move cars due in 2003 such as the Pontiac Vibe and Saturn Ion are engineered to be sportier than rival models. It does make gains, don't expect it to beat Toyota and Honda. Japan's No. 1 carmaker is increasing SUV and minivan sales, and are the most likely to hit increased sales targets. Popularity in November, Honda bucked the downward trend, increasing sales 4.6%. In November sales were off, but by 2%. It's easy to see why: Demand for companies' models keeps inventory at two-thirds the level of domestic producers.

Inevitably, though, the increased production means everyone will be scrapping for profits as competition heats up. Detroit's margins will be most threatened, because imports are hitting the truck market.

That's where the Big Three still get most of their earnings. But the massive new capacity means even Honda and Toyota could see slower profit growth. The only clear winners: U.S. car buyers, who will continue to be able to choose from plenty of good deals and new models.

Welch writes about the auto industry from Detroit.

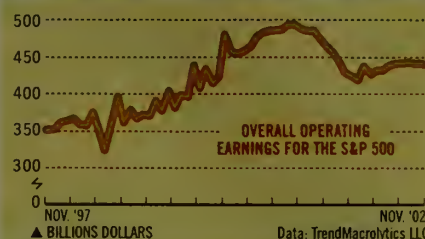
EARNINGS

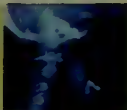
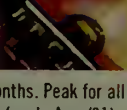
ON THE ROAD TO RECOVERY

But profit peaks aren't yet in sight for energy, tech, and telecom

It's easy to be pessimistic about the earnings outlook for Corporate America: Operating earnings for the Standard & Poor's 500-stock index for the 12 months ended Nov. 30 still sit 11% below the February, 2001, peak.

Does that mean Corporate America as a whole remains weak? No. While tech and telecom, along with basic materials and energy, remain in the tank, earnings in other areas are recovering. Indeed, remove tech and telecom from the S&P, and operating income is back to within 2.5% of the peak. Several sectors, including health care and finance, have moved beyond the boom-era high. "Investors have been myopic," says Donald L. Luskin, chief investment officer for TrendMacrolytics LLC, a Menlo Park (Calif.) research firm. "By obsessing on [tech] troubles, they've overlooked the strong performance" in a lot of industries. As the table below shows.



		BOOM ERA PEAK EARNINGS*	CURRENT EARNINGS**	CHANGE
(IN BILLIONS)				
HEALTH CARE		\$44	\$58	+31.8%
People still get sick, and they still shell out for drugs and hospitals				
FINANCIAL SERVICES		\$116	\$123	+6.0%
A mortgage boom has lenders laughing all the way to the bank				
CONSUMER STAPLES		\$42	\$44	+4.7%
Even during a recession, you gotta eat, shave, and wash the dishes				
UTILITIES		\$28	\$26	-7.1%
Enron's collapse triggered a credit crunch that left players struggling				
INDUSTRIALS		\$54	\$50	-7.4%
The old-fashioned business of regulated power is providing a salve				
CONSUMER DISCRETIONARY		\$60	\$54	-10.0%
Strong home sales and plucky consumers have stanchied the pain				
TELECOM SERVICES		\$34	\$21	-38.0%
Telecoms still haven't worked off a post-boom glut of excess capacity				
MATERIALS		\$17	\$9	-47.0%
Gluts, global competition, and asbestos litigation have hit earnings				
ENERGY		\$50	\$26	-48.0%
Companies have been whipsawed by volatile energy prices				
INFORMATION TECHNOLOGY		\$78	\$31	-60.0%
Tech firms have slashed costs, but orders still aren't flooding in				

*Overall operating earnings for the preceding 12 months. Peak for all companies is measured as of March, 2000, except for InfoTech (peak: Dec./00), Utilities (peak: Oct./01), and Energy (peak: Aug./01).

**Overall operating earnings for the preceding 12 months for all companies as of November, 2002.

Data: Trend Macrolytics LLC

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PHARMACEUTICALS

MERCK'S NEW ALCHEMIST

Can Peter Kim shake up the giant's R&D operations?

As a hotshot scientist at the Cambridge (Mass.)-based Whitehead Institute during the 1990s, Peter S. Kim never let minor obstacles stand in his way. Whitehead, the renowned biomedical research center affiliated with the Massachusetts Institute of Technology, didn't have quick access to powerful X-ray technology for Kim's protein structure research. So he persuaded higher-ups to foot the multimillion-dollar bill for new equipment that would allow immediate use of the super-powerful X-ray source at the government's Argonne National Laboratory. "His influence carried weight up to the highest levels," says Phillip A. Sharp, a Nobel laureate and biologist who is a professor at MIT, where Kim also taught.

The 44-year-old Kim will need that vision and drive in his new role at Merck & Co. On Dec. 2, Merck announced that Kim, who became a scientific superstar at Whitehead doing research into viruses like HIV, will take over as chief of the drugmaker's \$2.7 billion research and development operation at the start of 2003.

Kim, who was recruited to be executive vice-president of R&D at Merck in 2001, faces a daunting task. He must use his proven mastery of cutting-edge biology to help Merck harness the po-

tential of the genomics revolution. The new science has raised costs for every drugmaker in the near term but has yet to yield a wave of new products. The result is that Merck, like virtually every drugmaker, is struggling with a weak pipeline. "We need extraordinary leaders with biotechnology and genomics expertise," says Denise DeMan-Williams, founder of the pharmaceutical recruiting firm Bench International Search Inc.

At the core of Kim's strategy is a drive to cut the notoriously high failure rate of drug development. Just months after joining Merck, he persuaded Chairman and CEO Raymond V. Gilmartin to make a big bet on the emerging science of molecular profiling, which can give an early read on a drug's likely safety and effectiveness. Kim set his sights on the Kirkland (Wash.) biotech company Rosetta Inpharmatics Inc., striking a \$540 million deal to buy it in just a few weeks. "We needed to do molecular profiling, and I knew it would take a long time to build it internally," Kim says from his office at Merck's West Point (Pa.) labs.

If he's right, the Rosetta deal could pay big dividends. Rosetta studies patterns of how tens of thousands of genes are turned on and off in various tissues. Those tissues may be taken from

people or animals with certain diseases or that are taking drugs with known side effects, for example. Merck then tests drug candidates against those patterns. "If this cuts our failure rate, that is big," Kim says.

Kim's bold moves at Merck come no surprise to those who have followed his career. He made headlines in the 1990s for helping discover the mechanism that HIV and other viruses use to gain entry into healthy cells. "That was absolutely beautiful work," says Dani P. Bolognesi, chief executive officer of biotech player Trimeris Inc.

While Wall Streeters respect Kim's research credentials, they warn he has a tough transition to make. Analysts are anxiously awaiting Merck's Dec. 3 meeting, where Kim will give an update on Merck's pipeline. For now, though, most believe little quick improvement is in sight. With the \$7.5 billion cholesterol-lowering drug Zocor likely to face generic competition in 2006, Cowen Securities Corp. analyst Stephen M. Scala figures earnings in Merck's core drug business will grow at a compound annual growth rate of just 2% between 2001 and 2006. The industry should grow 8% to 10% for the period.

That's why some investors want to see Kim go hunting for drugs to license. "I would hope an outside guy [like Kim] will be able to shake things up," says Dr. John Borzilleri, portfolio manager at State Street Research & Management Co., a Merck shareholder. Revitalizing Merck's R&D operation may make decoding nature's most cunning viruses seem easy by comparison.

By Amy Barrett and John Carey in West Point, Pa.

PETER S. KIM

BORN April, 1958. Atlanta, Georgia.

EDUCATION AB in chemistry from Cornell University in 1979, PhD in biochemistry from Stanford University, 1985.

SCIENTIFIC CLAIM TO FAME

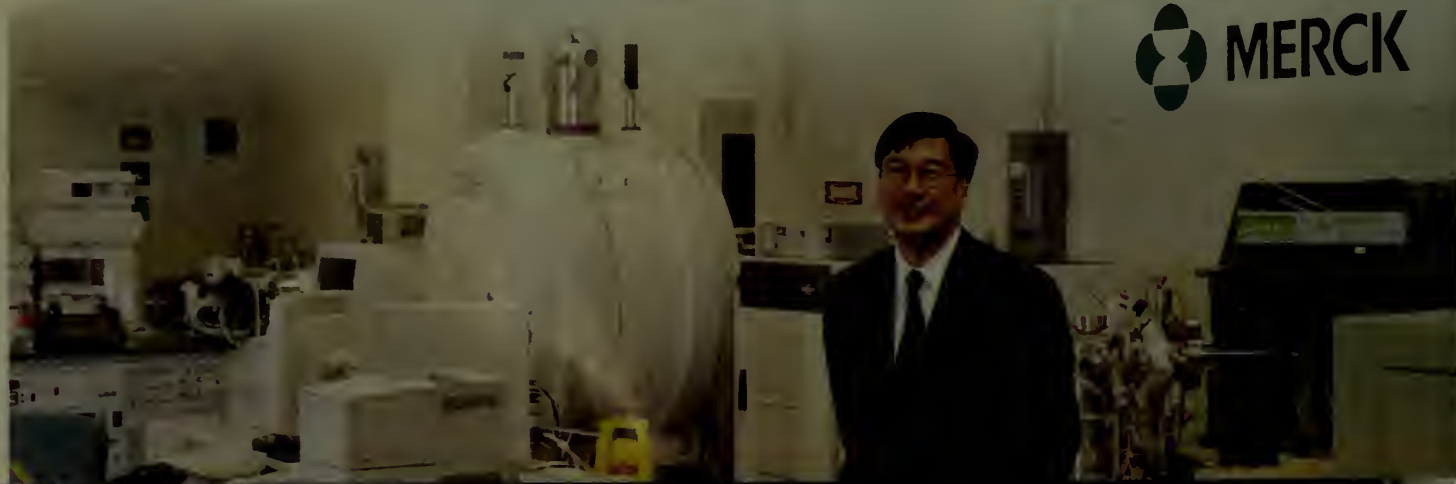
Kim helped discover how HIV uses a protein named gp41 as a harpoon to invade and attack healthy cells.

CHALLENGE AHEAD To fill Merck's declining pipeline by ramping up R&D productivity. He must also find new products

to license ahead of 2006, when patents expire for its biggest seller, the \$7.5 billion cholesterol-lowering drug Zocor.

GOAL "If my work actually leads to a real drug or vaccine, I would consider that one of my major accomplishments in life."

FAMILY Married with two children.





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INFORMATION TECHNOLOGY

IBM: A MATTER OF RATIONAL SELF-INTEREST

It's spending big to grab more of the Net software market

These days IBM's software group is hungrier than Tony Soprano on an empty stomach. Since 2001, it has spent about \$1.5 billion, gobbling up seven software companies as it continues to move into software and services. Now, *BusinessWeek* has learned, IBM is ready to chow down again. According to two execs familiar with the situation, the tech giant is in talks to acquire Rational Software Corp., a leading, yet vulnerable, maker of the digital tools used by developers to create Net software programs that run corporate operations.

For now, price is a sticking point and the deal could fall through. Neither side would comment. But if it happens, Rational would be IBM's largest software acquisition since its \$3.5 billion purchase of Lotus Notes Corp. in 1995.

It's easy to see why IBM is eager to get its

ADD TO CART:

Mills has more shopping to do

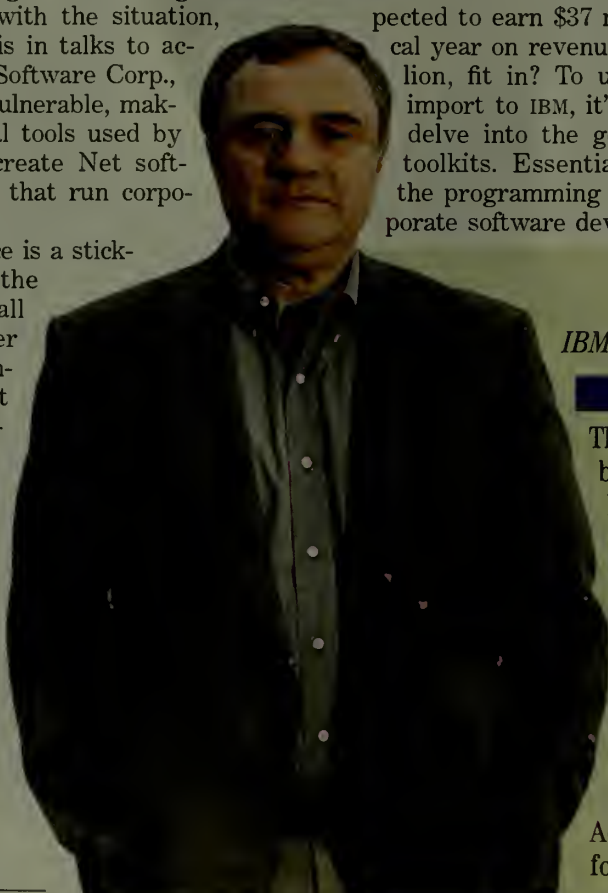
of sales and profits coming from software. For the last seven years, software chief Steve Mills has focused on building up IBM's position in the key, though hidden, programs that make up a company's computing infrastructure.

So where does Rational, which is expected to earn \$37 million this fiscal year on revenues of \$628 million, fit in? To understand its import to IBM, it's necessary to delve into the geeky world of toolkits. Essentially, these are the programming tools that corporate software developers use to



So if it's such a key market, why Rational considering selling out? In part, the company is vulnerable because of past overreliance on the battered telecom and telecom sectors. Their troubles caused sales to fall 15% for the fiscal year ended March 31, 2002, and Goldman, Sachs & Co. expects another sales drop in the current fiscal year. That helped send its market cap down 40% the last year, to around \$1.75 billion.

Investors are also worried about tough competition that could increasingly cloud Rational's future. Borland recently bought the small companies that specialize in design and configuration tools, and it clearly intends to move from basic to high-end tools. But the real threat is Microsoft, which is making the same move. While Rational has long been allied with Microsoft, the software giant now shows every sign of developing its own tools. With IBM's marketing muscle and corporate customer base to sell to, over the cou-



BIG BLUE'S BUYING SPREE

IBM is boosting its strength in three key software markets:

MIDDLEWARE

The purchase of CrossWorlds Software and Holosoft will broaden IBM's offerings of integration software, which helps customers exchange data.

DATABASE

Acquiring database maker Informix helped IBM overtake Oracle. The addition of content manager Tarian Software should provide further strength.

NETWORK MANAGEMENT

IBM boosted its expertise in managing storage devices by buying TrellisSoft, while the addition of Access360 lets IBM customers oversee computer access for employees, customers, and business partners.

hands on the Cupertino (Calif.) company. As more corporations use the Net to perform key business tasks, the software that allows them to create applications and Web services is growing in strategic importance. With sales Dataquest expects to hit \$5.5 billion in 2004, up from \$4.7 billion last year, it's not a sector IBM can afford to ignore. Others certainly aren't: The likes of Microsoft Corp. and Borland Software Corp. are also piling in. Buying Rational, says analyst Mike Gilpin of Giga Information Group Inc., "would position [IBM] to compete more effectively against Microsoft."

Such a move would also bolster IBM's long-stated goal of increasing the share

design the programs that allow consumers to buy books online or enable CFOs to run their financial reporting systems over the Net.

For software providers like IBM, building a strong tools business is critical: It's too expensive to train developers to use multiple toolkits, so buyers usually stick with one and its family of products. That means toolkit providers that lock customers in can drive sales of other software. But while IBM already makes its own basic toolkit, called WebSphere Studio, it doesn't have the high-end software needed to build the most sophisticated applications. It wants Rational to fill that hole.

of several years Microsoft could walk away with much of the business Rational now does for it. Rational "needs to be closer to IBM," warns Gilpin.

So what's holding up the deal? The main stumbling block, say sources, is price. Ben Howe, who has brokered several IBM deals as mergers and acquisitions chief at SG Cowen Securities Corp., believes Rational could fetch up to \$1 billion. That assumes a 30% premium to its current market cap, and Rational now trades at a discount to other infrastructure-software companies. For IBM bargain-hunters, that may be too rich.

By Spencer E. Ante in New York
with Jim Kerstetter in San Mateo, Calif.

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In Business This Week

EDITED BY MONICA ROMAN

UNITED: LOSING ALTITUDE

UAL LOST ITS LAST HOPE TO avoid filing for Chapter 11 bankruptcy protection on Dec. 4 when the government's Air Transportation Stabilization Board (ATSB) rejected the airline's request for a \$1.8 billion loan guarantee. The parent of United Airlines, the world's second-biggest carrier, had invoked a "grace period" clause on \$875 million in debt due on Dec. 2 and warned that it could not repay those obligations without government-backed loans. Even without a deal with its machinists, UAL had secured roughly \$820 million a year in wage cuts from its employees to help obtain federal assistance. But analysts and rivals had warned that the airline's restructuring was inadequate, noting that UAL itself said it wouldn't turn a profit until 2005. The ATSB concluded that UAL's revenue projections were "unreasonably optimistic" and that even

with all its cost cuts, it would probably face a cash crunch within a few years.

LEAVING DETROIT IN A CLOUD OF EXHAUST

HONDA AND TOYOTA STOLE A march on the Big Three by delivering the first fuel-cell vehicles designed for everyday use to the U.S. on Dec. 2. Fuel cells—which convert hydrogen to electric power with no polluting by-products—are seen as the most promising alternative to gasoline engines. Both Honda and Toyota's fuel-cell models use electric motor-drive controls derived from hybrid gas-electric cars the two have been selling in the U.S. for the past two years. The first production hybrid vehicle from a U.S. carmaker is expected next year from Ford.

A WOUNDED TENET SOLDIERS ON

MORE BAD NEWS FROM TENET Healthcare hasn't deterred investors. On Dec. 3, the Santa Barbara (Calif.) hospital operator dropped its earnings estimates for fiscal 2003 from \$1.4 billion to less than \$1.3 billion. It also expects earnings to slide to \$950 million in 2004. Tenet assumes that a Medicare loophole that had allowed it to collect unusually high payments will be closed. But Tenet promised to buy back some of its battered shares, sending its stock up 5%, to \$18.75, on Dec. 4.

DISNEY REDRAWS THE BOARD

ON DEC. 3, WALT DISNEY SAID it would reduce its fourth-quarter earnings by \$47 million because of the poor showing by its animated film *Treasure Planet*. The news sent shares tumbling 5% the next day. But Disney investors got better news else-

HEADLINER: DENNIS FITZSIMONS

THE KEY TO TRIBUNE'S KINGDOM

TURNING TO SOMEONE WHO has reached out to younger audiences, Tribune Co. has named Dennis FitzSimons CEO, effective Jan. 1. The parent of the *Los Angeles Times*, *Newsday*, *Chicago Tribune*, and 24 TV stations, Tribune

looks to the genial 52-year-old to boost circulation and viewership as audiences move away from big media. He is likely to shore up Tribune with more moves like his new youth-oriented RedEye edition of the *Chicago Tribune* and the development of the WB Television Network, which Tribune partly owns.



FitzSimons, a 20-year Tribune veteran who came up through the TV ranks, should be helped by fresh gains in print and TV advertising. After recovering from what predecessor John Madigan in late 2001 called the worst ad climate since the Great Depression, the mood "has improved quite a bit," says FitzSimons. Longer term, finding synergies among Tribune's holdings and keeping them growing are his primary challenges. Not to mention rebuilding the stock, which peaked at around \$60 in late 1999 and is now at \$45.

Joseph Weber

CLOSING BELL

BRAKING

Navistar International hit the skids on Dec. 3, announcing a larger-than-expected quarterly loss. The Warrenville (Ill.) company also warned it will lose money this quarter and perhaps throughout 2003, thanks to a persistent slump in big-truck orders. Shares fell 12%, to \$26, but rose to \$27.90 on Dec. 4.



where: Its board, under fire because of directors' close ties to Chairman Michael Eisner, underwent an overhaul. Former Senator George Mitchell (D-Me.) was elected presiding director. He will now hold at least two meetings a year without Eisner and other Disney execs. Remnants of the board's cozy relationship with the company remain, however: Disney said it was cooperating with a Securities & Exchange Commission inquiry into its disclosure that four board members had relatives working for the company.

And at a Dec. 3 hearing in private antitrust suit filed by Sun Microsystems, a U.S. District Court judge called Sun proposal to force Microsoft to carry its Java programming language inside Microsoft Windows operating system "attractive." Microsoft carried Java in the latest version of Windows but plans to stop it in 2004. Still, the skirmishes pose only a modest threat: The antitrust ruling leaves little room for appeal, and Microsoft's \$4 billion in cash offers ample cushion for any penalties.

ET CETERA...

- The SEC wants to crack down on accounting firm that sell tax advice to companies that they audit.
- Consultant Segal Group expects prescription drug price to rise nearly 20% next year.
- A former El Paso Corp. trader was indicted for allegedly reporting false trades.

MICROSOFT IS NOT OUT OF THE WOODS

AS THE DUST SETTLES FROM Microsoft's antitrust victory, the company is trying to douse some local brushfires. Massachusetts and West Virginia, which sought tougher sanctions than those agreed to by the feds, plan to appeal.



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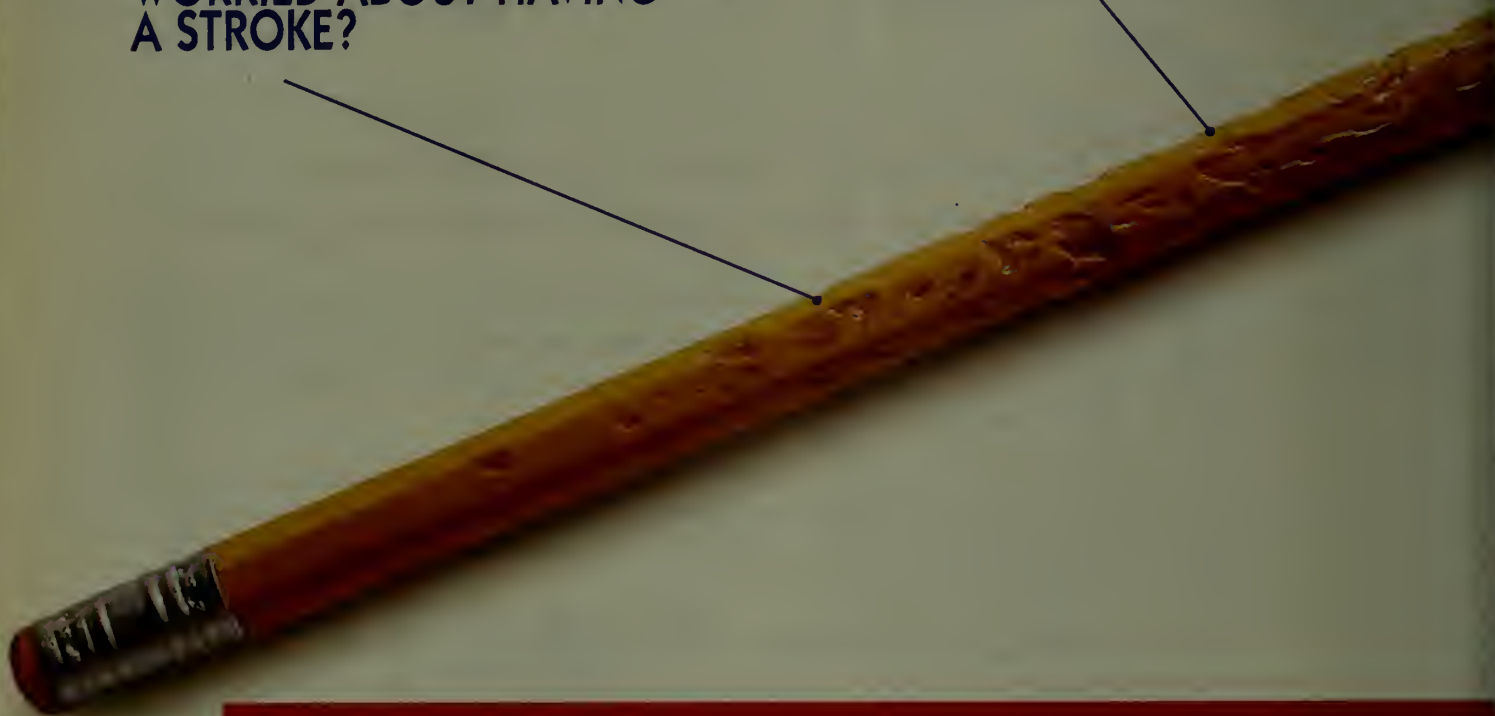
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Thin Frame	Yes	Yes	Yes	Yes	Yes	Yes	Yes
DDC/CI	No	No	Yes	Yes	Yes	Yes	Yes
No Touch Auto Adjust	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Integration Capable	Yes	Yes	No	Yes	Yes	No	Yes
LiquidView™ Software	No	No	No	Yes	Yes	Yes	No
Multimedia	No	No	Yes	No	No	Yes	No
Vacation Switch	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Cable Management	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Input Interface Connectors	VGA	DVI-D & VGA	DVI-D & VGA	VGA	DVI-D & VGA	DVI-D & VGA	DVI-D & VGA

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*Pearson, *Arch Intern Med.* 2000; 160:459-467.

†Leading brand is the number one prescribed brand of cholesterol lowering medication in the U.S., according to IMS National Prescription Audit, week of 8/19/02.

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CONTRAINDICATIONS: Hypersensitivity to any component of this medication. Active liver disease or unexplained, persistent elevations in liver function tests (see **WARNINGS**). **Pregnancy and Lactation:** Pravastatin is a chronic process and discontinuation of lipid-lowering drugs during pregnancy should have little impact on the outcome of long-term therapy of primary hypercholesterolemia. Cholesterol and other products of cholesterol biosynthesis are essential components for fetal development (including synthesis of steroids and cell membranes). Since HMG-CoA reductase inhibitors decrease cholesterol synthesis and possibly the synthesis of other biologically active substances derived from cholesterol, they are contraindicated during pregnancy and in nursing mothers. Pravastatin should be administered to women of childbearing age only when such patients are highly unlikely to conceive and have been informed of the potential hazards. If the patient becomes pregnant while taking this class of drug, therapy should be discontinued immediately and the patient apprised of the potential hazard to the fetus (see **PRECAUTIONS: Pregnancy**).

WARNINGS: Liver Enzymes: HMG-CoA reductase inhibitors, like some other lipid-lowering therapies, have been associated with biochemical abnormalities of liver function. In three long-term (4.8-5.9 years), placebo-controlled clinical trials (WOS, LIPID, CARE), 19,592 subjects (19,768 randomized), were exposed to pravastatin or placebo. In an analysis of serum transaminase values (ALT, AST), incidences of marked abnormalities were compared between the pravastatin and placebo treatment groups; a marked abnormality was defined as a post-treatment test value greater than three times the upper limit of normal for subjects with pretreatment values less than or equal to the upper limit of normal, or four times the pretreatment value for subjects with pretreatment values greater than the upper limit of normal but less than 1.5 times the upper limit of normal. Marked abnormalities of ALT or AST occurred with similar low frequency ($\leq 1.2\%$) in both treatment groups. Overall, clinical trial experience showed that liver function test abnormalities observed during pravastatin therapy were usually asymptomatic, not associated with cholestasis, and did not appear to be related to treatment duration. It is recommended that liver function tests be performed prior to the initiation of therapy, prior to the elevation of the dose, and when otherwise clinically indicated. Active liver disease or unexplained persistent transaminase elevations are contraindications to the use of pravastatin (see **CONTRAINDICATIONS**). Caution should be exercised when pravastatin is administered to patients who have a recent history of liver disease, have signs that may suggest liver disease (e.g., unexplained aminotransferase elevations, jaundice), or are heavy users of alcohol (see **CLINICAL PHARMACOLOGY: Pharmacokinetics/Metabolism**). Such patients should be closely monitored, started at the lower end of the recommended dosing range, and titrated to the desired therapeutic effect. Patients who develop increased transaminase levels or signs and symptoms of liver disease should be monitored with a second liver function evaluation to confirm the finding and be followed thereafter with frequent liver function tests until the abnormality(ies) return to normal. Should an increase in ALT or AST of three times the upper limit of normal or greater persist, withdrawal of pravastatin therapy is recommended. **Skeletal Muscle:** Rare cases of rhabdomyolysis with acute renal failure secondary to myoglobinuria have been reported with pravastatin and other drugs in this class. Uncomplicated myalgia has also been reported in pravastatin-treated patients (see **ADVERSE REACTIONS**). Myopathy, defined as muscle aching or muscle weakness in conjunction with increases in creatine phosphokinase (CPK) values to greater than 10 times the upper normal limit, was rare ($<0.1\%$) in pravastatin clinical trials. Myopathy should be considered in any patient with diffuse myalgias, muscle tenderness or weakness, and/or marked elevation of CPK. Patients should be advised to report promptly unexplained muscle pain, tenderness or weakness, particularly if accompanied by malaise or fever. Pravastatin therapy should be discontinued if markedly elevated CPK levels occur or myopathy is diagnosed or suspected. Pravastatin therapy should also be temporarily withheld in any patient experiencing an acute or serious condition predisposing to the development of renal failure secondary to rhabdomyolysis, e.g., sepsis, hypotension, major surgery, trauma, severe metabolic, endocrine, or electrolyte disorders, or uncontrolled epilepsy. The risk of myopathy during treatment with another HMG-CoA reductase inhibitor is increased with concurrent therapy with either erythromycin, cyclosporine, niacin, or fibrates. However, neither myopathy nor significant increases in CPK levels have been observed in three reports involving a total of 100 post-transplant patients (24 renal and 76 cardiac) treated for up to two years concurrently with pravastatin 10-40 mg and cyclosporine. Some of these patients also received other concomitant immunosuppressive therapies. Further, in clinical trials involving small numbers of patients who were treated concurrently with pravastatin and niacin, there were no reports of myopathy. Also, myopathy was not reported in a trial of combination pravastatin (40 mg/day) and gemfibrozil (1200 mg/day), although 4 of 75 patients on the combination showed marked CPK elevations versus one of 73 patients receiving placebo. There was a trend toward more frequent CPK elevations and patient withdrawals due to musculoskeletal symptoms in the group receiving combined treatment as compared with the groups receiving placebo, gemfibrozil, or pravastatin monotherapy (see **PRECAUTIONS: Drug Interactions**). The use of fibrates alone may occasionally be associated with myopathy. The combined use of pravastatin and fibrates should be avoided unless the benefit of further alterations in lipid levels is likely to outweigh the increased risk of this drug combination.

PRECAUTIONS: General: PRAVACHOL may elevate creatine phosphokinase and transaminase levels (see **ADVERSE REACTIONS**). This should be considered in the differential diagnosis of chest pain in a patient on therapy with pravastatin. **Homozygous Familial Hypercholesterolemia:** Pravastatin has not been evaluated in patients with rare homozygous familial hypercholesterolemia. In this group of patients, it has been reported that HMG-CoA reductase inhibitors are less effective because the patients lack functional LDL receptors. **Renal Insufficiency:** A single 20 mg oral dose of pravastatin was administered to 24 patients with varying degrees of renal impairment (as determined by creatinine clearance). No effect was observed on the pharmacokinetics of pravastatin or its 3 α -hydroxy isomeric metabolite (SQ 31,906). A small increase was seen in mean AUC values and half-life ($t_{1/2}$) for the inactive enantiomeric ring hydroxylated metabolite (SQ 31,945). Given this small sample size, the dosage administered, and the degree of individual variability, patients with renal impairment who are receiving pravastatin should be closely monitored. **Information for Patients:** Patients should be advised to report promptly unexplained muscle pain, tenderness or weakness, particularly if accompanied by malaise or fever (see **WARNINGS: Skeletal Muscle**). **Drug Interactions: Immunosuppressive Drugs, Gemfibrozil, Niacin (Nicotinic Acid), Erythromycin:** See **WARNINGS: Skeletal Muscle**. **Cytochrome P450 3A4 Inhibitors:** In vitro and in vivo data indicate that pravastatin is not metabolized by cytochrome P450 3A4 to a clinically significant extent. This has been shown in studies with known cytochrome P450 3A4 inhibitors (see **Drug Interactions** and **Contraindications**). Other examples of cytochrome P450 3A4 inhibitors include ketoconazole, mifepridone, and erythromycin. **Diltiazem**—Steady-state levels of diltiazem (a known, weak inhibitor of P450 3A4) had no effect on the pharmacokinetics of pravastatin. In this study, the AUC and C_{max} of another HMG-CoA reductase inhibitor which is known to be metabolized by cytochrome P450 3A4 increased by factors of 3.6 and 4.3, respectively, with diltiazem. The mean AUC and C_{max} for pravastatin were increased by factors of 1.7 and 2.5, respectively, when given with diltiazem (a potent P450 3A4 inhibitor which also inhibits p-glycoprotein transport) as compared to placebo. The mean $t_{1/2}$ was not affected by diltiazem, suggesting that the relatively small increases in C_{max} and AUC were due solely to increased bioavailability rather than a decrease in clearance, consistent with inhibition of p-glycoprotein transport by diltiazem. This drug transport system is thought to affect bioavailability and excretion of HMG-CoA reductase inhibitors, including pravastatin. The AUC and C_{max} of another HMG-CoA reductase inhibitor which is known to be metabolized by cytochrome P450 3A4 increased by factors of 1.9 and 1.7, respectively, when given with diltiazem. **Antipyrine:** Since concomitant administration of pravastatin had no effect on the clearance of antipyrine, interactions with other drugs metabolized via the same hepatic cytochrome isozymes are not expected. **Cholestyramine/Colestipol:** Concomitant administration resulted in an approximately 40 to 50% decrease in the mean AUC of pravastatin. However, when pravastatin was administered 1 hour before or 4 hours after cholestyramine or 1 hour before colestipol and a standard meal, there was no clinically significant decrease in bioavailability or therapeutic effect. (See **DOSE AND ADMINISTRATION: Concomitant Therapy**). **Warfarin:** Concomitant administration of 40 mg pravastatin had no clinically significant effect on prothrombin time when administered in a study to normal elderly subjects who were stabilized on warfarin. **Cimetidine:** The AUC_{0-12 h} for pravastatin when given with cimetidine was not significantly different from the AUC for pravastatin when given alone. A significant difference was observed between the AUCs for pravastatin when given with cimetidine compared to when administered with antacid. **Digoxin:** In a crossover trial involving 18 healthy male subjects given 20 mg pravastatin and 0.2 mg digoxin concurrently for 9 days, the bioavailability parameters of digoxin were not affected. The AUC of pravastatin tended to increase, but the overall bioavailability of pravastatin plus its metabolites SQ 31,906 and SQ 31,945 was not altered. **Cyclosporine:** Some investigators have measured cyclosporine levels in patients on pravastatin (up to 20 mg), and to date, these results indicate no clinically meaningful elevations in cyclosporine levels. In one single-dose study, pravastatin levels were found to be increased in cardiac transplant patients receiving cyclosporine. **Gemfibrozil:** In a crossover study in 20 healthy male volunteers given concomitant single doses of pravastatin and gemfibrozil, there was a significant decrease in urinary excretion and protein binding of pravastatin. In addition, there was a significant increase in AUC, C_{max} , and T_{max} for the pravastatin metabolite SQ 31,906. Combination therapy with pravastatin and gemfibrozil is generally not recommended. (See **WARNINGS: Skeletal Muscle**.) In interaction studies with aspirin, antacids (1 hour prior to PRAVACHOL), cimetidine, nicotinic acid, or probucol, no statistically significant differences in bioavailability were seen when PRAVACHOL was administered. **Endocrine Function:** HMG-CoA reductase inhibitors interfere with cholesterol synthesis and lower circulating cholesterol levels and, as such, might theoretically blunt adrenal or gonadal steroid hormone production. Results of clinical trials with pravastatin in males and post-menopausal females were inconsistent with regard to possible effects of the drug on basal steroid hormone levels. In a study of 21 males, the mean testosterone response to human chorionic gonadotropin was significantly reduced ($p<0.004$) after 16 weeks of treatment with 40 mg of pravastatin. However, the percentage of patients showing a $>50\%$ rise in plasma testosterone after human chorionic gonadotropin stimulation did not change significantly after therapy in these patients. The effects of HMG-CoA reductase inhibitors on spermatogenesis and fertility have not been studied in adequate numbers of patients. The effects, if any, of pravastatin on the pituitary-gonadal axis in pre-menopausal females are unknown. Patients treated with pravastatin who display clinical evidence of endocrine dysfunction should be evaluated appropriately. Caution should also be exercised if an HMG-CoA reductase inhibitor or other agent used to lower cholesterol levels is administered to patients also receiving other drugs (e.g., ketoconazole, spiroinolactone, cimetidine) that may diminish the levels or activity of steroid hormones. **CNS Toxicity:** CNS vascular lesions, characterized by perivascular hemorrhage and edema and mononuclear cell infiltration of perivascular spaces, were seen in dogs treated with pravastatin at a dose of 25 mg/kg/day. These effects in dogs were observed at approximately 59 times the human dose of 80 mg/day, based on AUC. Similar CNS vascular lesions have been observed with several other drugs in this class. A chemically similar drug in this class produced optic nerve degeneration (Wallenian degeneration of retinogenicular fibers) in clinically normal dogs in a dose-dependent fashion starting at 60 mg/kg/day, a dose that produced mean plasma drug levels about 30 times higher than the mean drug level in humans taking the highest recommended dose (as measured by total enzyme inhibitory activity). This same drug also produced vestibulocochlear Wallenian-like degeneration and retinal ganglion cell chromatolysis in dogs treated for 14 weeks at 180 mg/kg/day, a dose which resulted in a mean plasma drug level similar to that seen with the 60 mg/kg/day dose. **Carcinogenesis, Mutagenesis, Impairment of Fertility:** Please see Full Prescribing Information. **Pregnancy: Pregnancy Category X.** See **CONTRAINDICATIONS**. Safety in pregnant women has not been established. Pravastatin was not teratogenic in rats at doses up to 1000 mg/kg daily or in rabbits at doses of up to 50 mg/kg daily. These doses resulted in 10x (rabbit) or 120x (rat) the human exposure based on surface area (mg/m²). Rare reports of congenital anomalies have been received following

intrauterine exposure to other HMG-CoA reductase inhibitors. In a review¹ of approximately 100 prospectively followed pregnancies in women exposed to simvastatin or lovastatin, the incidences of congenital anomalies, spontaneous abortions and deaths/stillbirths did not exceed what would be expected in the general population. The number of cases is adequate to exclude a three-to-four-fold increase in congenital anomalies over the background incidence. In 89% of the prospectively followed pregnancies, drug treatment was initiated prior to pregnancy and was discontinued at some point in the first trimester when pregnancy was identified. As safety in pregnant women has not been established and there is no apparent benefit to therapy with PRAVACHOL (pravastatin sodium) during pregnancy (see **CONTRAINDICATIONS**), treatment should be immediately discontinued as soon as pregnancy is recognized. PRAVACHOL should be administered to women of child-bearing potential only when patients are highly unlikely to conceive and have been informed of the potential hazards. **Nursing Mothers:** A small amount of pravastatin is excreted in human breast milk. Because of the potential for serious adverse reactions in nursing infants, nursing mothers should not nurse (see **CONTRAINDICATIONS**). **Pediatric Use:** Safety and effectiveness in individuals less than 18 years old have not been established. Hence, treatment in patients less than 18 years old is not recommended at this time. **Geriatric Use:** Two secondary prevention trials with pravastatin (CARE and LIPID) included a total of 6,593 subjects treated with pravastatin 40 mg for periods ranging up to 6 years. Across these two studies, 36.1% of pravastatin subjects were aged 65 and older, 0.8% were aged 75 and older. The beneficial effect of pravastatin in elderly subjects in reducing cardiovascular events and in achieving lipid profiles was similar to that seen in younger subjects. The adverse event profile in the elderly was similar to that of the overall population. Other reported clinical experience has not identified differences in responses to pravastatin between elderly and younger patients. Mean pravastatin AUCs are slightly (25-50%) higher in elderly subjects than in healthy young subjects, but C_{max} , T_{max} and $t_{1/2}$ values are similar in both age groups and substantial accumulation of pravastatin would not be expected in elderly (see **CLINICAL PHARMACOLOGY: Pharmacokinetics/Metabolism**).

ADVERSE REACTIONS: Pravastatin is generally well tolerated; adverse reactions have usually been mild and transient. In 4-week placebo-controlled trials, 1.7% of pravastatin-treated patients and 1.2% of placebo-treated patients were discontinued treatment because of adverse experiences attributed to study drug therapy, this difference was not statistically significant also **PRECAUTIONS: Geriatric Use** section.)

Adverse Clinical Events: Short-Term Controlled Trials: All adverse clinical events (regardless of attribution) reported in more than 2% of pravastatin-treated patients in placebo-controlled trials of up to four months duration are identified in the table also shown are the percentages of patients in whom these medical events were believed to be related or possibly related drug.

Body System/Event	All Events		Events Attributed to Study Drug	
	Pravastatin (N = 900) % of patients	Placebo (N = 411) % of patients	Pravastatin (N = 900) % of patients	Placebo (N = 411) % of patients
Cardiovascular				
Cardiac Chest Pain	4.0	3.4	0.1	0.0
Dermatologic				
Rash	4.0*	1.1	1.3	0.9
Gastrointestinal				
Nausea/Vomiting	7.3	7.1	2.9	3.4
Diarrhea	6.2	5.6	2.0	1.9
Abdominal Pain	5.4	6.9	2.0	3.9
Constipation	4.0	7.1	2.4	5.1
Flatulence	3.3	3.6	2.7	3.4
Heartburn	2.9	1.9	2.0	0.7
General				
Fatigue	3.8	3.4	1.9	1.0
Chest Pain	3.7	1.9	0.3	0.2
Influenza	2.4*	0.7	0.0	0.0
Musculoskeletal				
Localized Pain	10.0	9.0	1.4	1.5
Myalgia	2.7	1.0	0.6	0.0
Nervous System				
Headache	6.2	3.9	1.7*	0.2
Dizziness	3.3	3.2	1.0	0.5
Renal/Genitourinary				
Urinary Abnormality	2.4	2.9	0.7	1.2
Respiratory				
Common Cold	7.0	6.3	0.0	0.0
Rhinitis	4.0	4.1	0.1	0.0
Cough	2.6	1.7	0.1	0.0

*Statistically significantly different from placebo.

The safety and tolerability of PRAVACHOL at a dose of 80 mg in two controlled trials with a mean exposure of 8.6 months similar to that of PRAVACHOL at lower doses except that 4 out of 464 patients taking 80 mg of pravastatin had a single tonic of CK $>10\times$ ULN compared to 0 out of 115 patients taking 40 mg of pravastatin.

Long-Term Controlled Morbidity and Mortality Trials: Adverse event data were pooled from seven double-blind, controlled trials (West of Scotland Coronary Prevention study [WOSC]; Cholesterol and Recurrent Events study [CARE]; Lovastatin Intervention in Ischemic Disease study [LIPID]; Pravastatin Limitation of Atherosclerosis in the C. Arteries study [PLAC II]; Pravastatin, Lipids and Atherosclerosis in the Carotids study [PLAC II]; Regression Growth Evaluation Study [REGRESS]; and Kuopio Atherosclerosis Prevention Study [KAPS]) involving a total of 10,764 patients treated with pravastatin 40 mg and 10,719 patients treated with placebo. The safety and tolerability profile in the pravastatin group comparable to that of the placebo group. Patients were exposed to pravastatin for a mean of 4.0 to 5.1 years in WOSC and LIPID and 1.9 to 2.9 years in PLAC I, PLAC II, KAPS, and REGRESS. In these long-term trials, the most common reason for discontinuation were mild, non-specific gastrointestinal complaints. Collectively, these seven trials represent 47,613 years of exposure to pravastatin. Events believed to be of probable, possible, or uncertain relationship to study drug, or in at least 1% of patients treated with pravastatin in these studies are identified as follows. **Adverse Events in $\geq 1\%$ of Patients Treated with Pravastatin 40 mg in Long-Term Placebo-Controlled Trials (Pravastatin (N = 10,764) % of p vs. Placebo (N = 10,719) % of patients) in each Body System/Event:** Cardiovascular: Angina Pectoris (3.1 v 2.6%); Rash (2.1 v 2.2%); Gastrointestinal: Dyspepsia/Heartburn (3.5 v 3.7); Abdominal Pain (2.4 v 2.6%); Musculoskeletal: Musculoskeletal Pain (includes arthralgia) (6.0 v 5.8); Muscle Cramp (2.0 v 1.8); Myalgia (1.4 v 1.4); Nervous System: Dizziness (2.2 v 2.1); Headache (1.9 v 1.8); Sleep Disturbance (1.0 v 0.9); Depression (1.0 v 0.9); Anxiety/Nervousness (1.0 v 1.2); Renal/Genitourinary: Urinary Abnormality (includes dysuria, frequency, nocturia) (1.0 v 1.0); Respiratory: Dyspnea (1.6 v 1.6); Upper Respiratory Infection (1.3 v 1.3); Cough (1.6 v 1.0); Special Senses: Disturbance (includes blurred vision, diplopia) (1.6 v 1.3).

Events of probable, possible, or uncertain relationship to study drug that occurred in $<1\%$ of pravastatin-treated patients in the long-term trials included the following: frequencies were similar in placebo-treated patients. **Dermatologic:** pruritus, matitis, dryness of skin, scalp hair abnormality (including alopecia), urticaria. **Endocrine/Metabolic:** sexual dysfunction change. **Gastrointestinal:** decreased appetite. **General:** fever, flushing. **Immunologic:** allergy, edema, hives. **Musculoskeletal:** muscle weakness. **Nervous System:** paresthesia, vertigo, insomnia, memory impairment, tremor, neu (including peripheral neuropathy). **Special Senses:** lens opacity, taste disturbance. **Postmarketing Experience:** In addition to the events reported above, as with other drugs in this class, the following events have been reported rarely during postmarketing experience with PRAVACHOL (pravastatin sodium), regardless of causality assessment. **Musculoskeletal:** myopathy, rhabdomyolysis. **Nervous System:** dysfunction of certain cranial nerves (including alteration of taste, impairment of ocular movement, facial paresis), peripheral nerve palsy. **Hypersensitivity:** anaphylaxis, lupus erythematosus-like syndrome, polyarthritis, dermatomyositis, vasculitis, purpura, hemolytic anemia, positive ANA, ESR increase, arthralgia, arthrosis, asthenia, photosensitivity, chills, malaise, toxic epidermal necrolysis, erythema multiforme, including Stevens-Johnson syndrome. **Gastrointestinal:** pancreatitis, hepatitis, including chronic active hepatitis, cholestatic jaundice, fatty change in cirrhosis, fulminant hepatic necrosis, hepatoma. **Dermatologic:** A variety of skin changes (e.g., nodules, discoloration, of mucous membranes, changes to hair/nails). **Reproductive:** gynecostasia. **Laboratory Abnormalities:** elevated alkaline phosphatase, and bilirubin; thyroid function abnormalities. **Laboratory Test Abnormalities:** Increases in serum transaminase (AST) values and CPK have been observed (see **WARNINGS**). Transient, asymptomatic eosinophilia has been reported. Effects usually returned to normal despite continued therapy. Anemia, thrombocytopenia, and leukopenia have been with HMG-CoA reductase inhibitors. **Concomitant Therapy:** Pravastatin has been administered concurrently with choline, colestipol, nicotinic acid, probucol and gemfibrozil. Preliminary data suggest that the addition of either probucol or gemfibrozil to therapy with lovastatin or pravastatin is not associated with greater reduction in LDL-cholesterol than that with lovastatin or pravastatin alone. No adverse reactions unique to the combination or in addition to those previously reported for each drug alone have been reported. Myopathy and rhabdomyolysis (with or without acute renal failure) have been reported when another HMG-CoA reductase inhibitor was used in combination with immunosuppressive drugs, gemfibrozil, erythromycin, or lipid-lowering doses of nicotinic acid. Concomitant therapy with HMG-CoA reductase inhibitors and agents is generally not recommended. (See **WARNINGS: Skeletal Muscle** and **PRECAUTIONS: Drug Interactions**.)

OVERDOSAGE: To date, there has been limited experience with overdosage of pravastatin. If an overdose occurs, it should be managed symptomatically with laboratory monitoring and supportive measures should be instituted as required. (See **WARNINGS: Exposure During Pregnancy**. Reproductive Toxicology 10(6): 439-446, 1996.



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EDITED BY JOHN CAREY

THE ENVIROS TRY AN END RUN AROUND WASHINGTON

With the White House seemingly dedicated to the proposition that conservation is for wimps, environmentalists braced for the worst when Republicans won back control of Congress. At risk, they feared, were bedrock laws protecting air, water, public lands, and endangered species. Sure enough, just weeks after the election, the Administration began issuing proposals that make it easier for companies to modernize plants without installing costly pollution controls and for federal land managers to step up the pace of logging.

"The very foundation of how we protect the environment is being undermined," says Debbie Case, legislative director of the Sierra Club. "For the next two years, we will be playing a very, very serious defense."

But how? The greens have only a small hope that moderate Republicans can rein in their all-at-full-speed colleagues like incoming Senate Environment & Public Works Committee chairman James M. Inhofe of Oklahoma. That's why the enviros are making a key shift in strategy. Instead of vainly lobbying lawmakers, they're increasingly going straight to the public. Their intention is not just to put grassroots pressure on Washington. They also hope to persuade corporations, which have poured millions into GOP coffers in expectation of less regulation, to mend their ways. "We can get something done in Washington, or we can go directly to the marketplace," explains Todd Paglia, campaign director for ForestEthics, a forest protection group.

By staging protests at Staples stores, Paglia's group recently persuaded the company to triple the recycled content of its paper products. It "showed us we could do more within the confines of good business practices," says Staples Vice-Chairman Joseph S. Vassalluzzo. Buoyed by such successes, enviros have everyone from retailers and Wall Street to Big in their sights. "Companies are very sensitive to anything

that would put their brand name in a bad light," says National Environmental Trust President Phil Clapp.

The Rainforest Action Network (RAN) is targeting banks that finance eco-unfriendly projects like pipelines that run through forests. Stop the funding, the theory goes, and the projects won't happen. ABN Amro and HSBC have agreed to pull back, so RAN has moved on to Citigroup, staging protests and running ads asking customers to cut up their credit cards. Thus far, RAN has received more than 20,000 mutilated cards. Citigroup says it agrees with RAN's causes but calls its "portrayal of our involvement in various projects...highly misleading."

Another battleground: energy. With no hope of getting energy-efficient bills through Congress, enviros are taking on Detroit and Big Oil. The Sierra Club is urging people to write to Ford, demanding fuel-saving technologies in SUVs. Soon, the group will launch a campaign charging that GM is irresponsible for building the Hummer. And Greenpeace is organizing boycotts of gas stations to force ExxonMobil to soften its hard-line stance on global warming. "Being handed a reputation as environmental enemy No.1 for such a big customer-facing business has to be considered a brand risk," warns a recent Deutsche Bank report on the company. Meantime, enviros are hoping to pin that label on Washington, too.

Still, it will be a hard sell. To avoid a backlash like the furor over relaxed arsenic standards, which embarrassed President Bush early in his term, the White House is spinning the new proposals as mere streamlining of cumbersome regulations. "We've got our work cut out for us," says New York Representative Sherwood Boehlert, a rare pro-environmental Republican. But in today's Washington, an outside-the-Beltway strategy may be the enviros' only hope.

By Laura Cohn, with Heather Timmons in New York



INHOFE: Green meanie?

CAPITAL WRAPUP

WHITHER HARVEY?

Outgoing SEC Chairman Harvey Pitt isn't going back to his old law firm, sources say. Pitt resigned under fire on Nov. 5 but is still at the agency awaiting the appointment of a successor. He is expected to return to Fried Frank Harris Shriver & Jacobson, where he pulled down \$3 million a year as the go-to guy for Wall Street and accounting firms. But sources say neither Pitt nor Fried Frank have put out feelers about his return, and close friends say Pitt may stick with his early

pledge not to practice law at all after leaving the SEC. Other options: teaching or consulting.

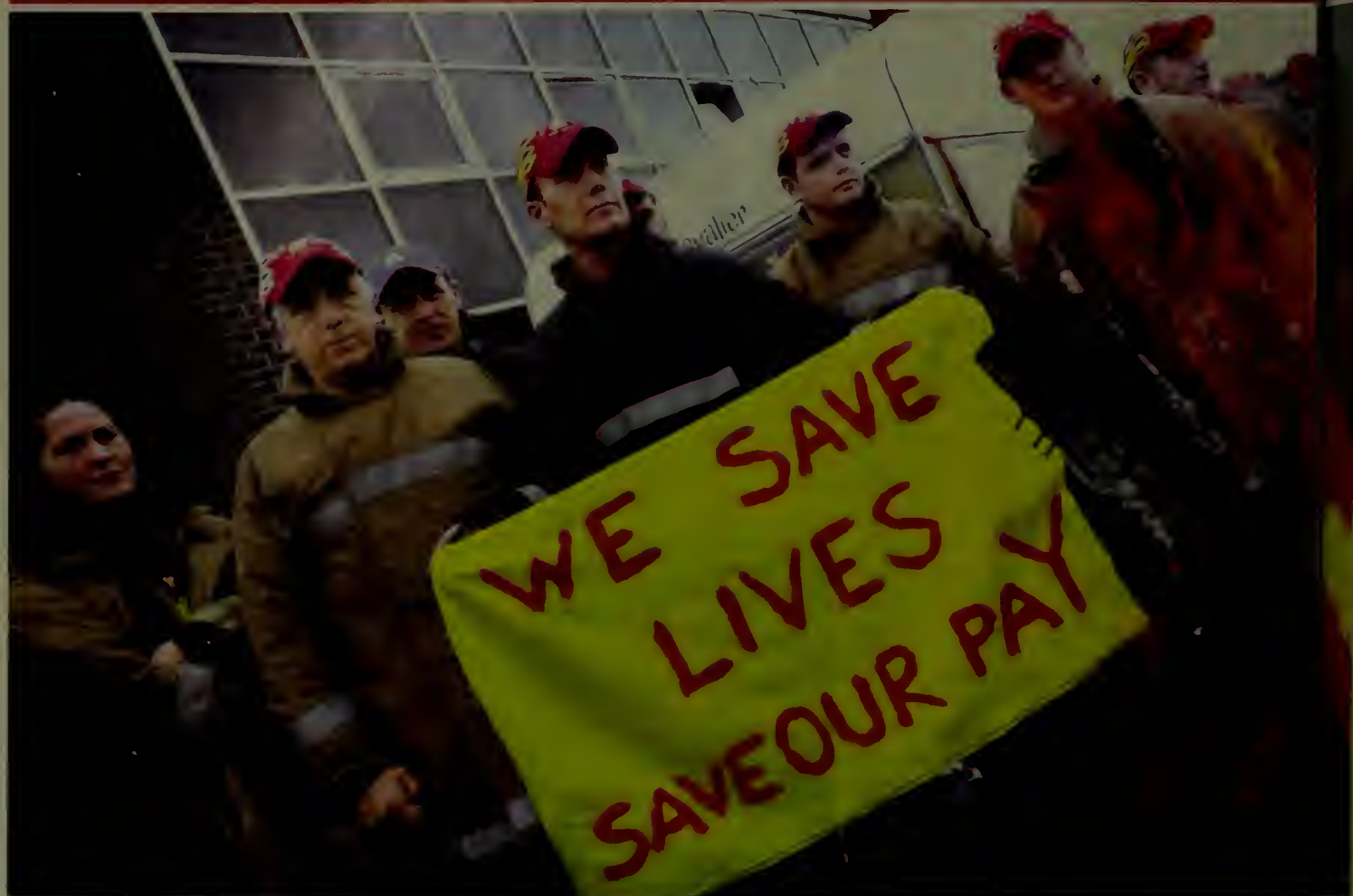
GRAMM'S LEFTOVERS

► Retiring Senator Phil Gramm (R-Tex.), a prodigious fund-raiser, has turned over some \$2 million in his reelection war chest to a new group, the Friends of Phil Gramm PAC. That lets Gramm use his campaign leftovers to support other candidates or causes as he sees fit. He can even spend it on travel and entertainment to raise more PAC money. Such a large kitty gives

Gramm, soon to become a vice-chairman at investment bank UBS Warburg, financial muscle in Washington. UBS's own PAC contains only \$29,000.

BOEING LEASE STALLED

► Defense Secretary Donald Rumsfeld's decision on whether to O.K. the Air Force's controversial bid to lease Boeing 767s as refueling tankers, expected by yearend, won't come until spring, a defense official says. Delays are troubling the Air Force, which believes low interest rates and the ailing airline industry give it leverage now.



BRITAIN

EUROPE'S NEW SICK MAN?

Suddenly, Britain is struggling

The news just keeps getting worse. Productivity and investment growth are slowing. Taxes are rising, and business is choking on reams of red tape. Meanwhile, the government's finances are deteriorating, and public services are a mess. Each day it seems yet another militant union threatens to take to the picket lines. Welcome to France? Not quite. This is Britain, the country long held up as a

model of economic success in Europe.

Those who praised Britain are turning into its biggest critics. A growing chorus of executives believe the nation's hard-won economic competitiveness is being eroded by the policies of the Labour government. Rising taxes and a slew of new rules on everything from employment to product labeling are putting a damper on local and foreign investment, they claim. Executives also

grouse that the government's decision not to adopt the euro is making the exports more expensive than those of European rivals. Toss in mounting worker unrest—firefighters and teachers among those who have recently gone on strike—and it's easy to see why Britain Inc. is concerned.

Two-thirds of CEOs of British enterprises say the country has become less business-friendly than it was when Prime Minister Tony Blair came to power five years ago, according to a recent survey by London-based polling agency MORI and the Confederation of British Industry (CBI). "The combined burden of higher taxes, onerous regulations, and the government's failure to recognize the high cost of staying outside the euro is seriously hurting my business," says Andrew Cook, chairman of William Cook Cast Products. The Sheffield-based steel company has just closed one of six plants in England and plans to move more production to China.

It's quite a reversal of fortune for a country that was once viewed as the economic dynamo of Europe and a source of inspiration for the Continent. Although it has preserved its gener-

The economy is still in better shape than many on the Continent

WHAT'S BOTHERING BRITAIN INC.

RISING TAXES

A slew of tax hikes since Labour came to power in 1997 will push up the ratio of public spending to GDP to 42% from 38% at present.

TOO MUCH RED TAPE

New and proposed employment legislation at both the national and European level is undermining Britain's flexible labor market and costing employers \$23 billion a year.

EURO-PARALYSIS

No clear government policy about if and when Britain will join the euro complicates investment and strategic decisions and exposes British businesses to currency fluctuations.



LABOR UNREST

Increasing militancy of unions is spooking employers. Public-sector pay increases will eat funds otherwise destined for health and education.

Data: Confederation of British Industry, BusinessWeek

STRIKING FIREFIGHTERS: WITH STATE FINANCES IN BAD SHAPE, HOW WILL BLAIR PAY ANGRY WORKERS?

are state, Britain's flexible labor and competitive tax rates are in k contrast to the high taxes, bureaucracy, and inefficiency that crimp wth across the Channel.

he fear now is that the Blair government is squandering the so-called tcher dividend, derived from the t-market reforms instituted during last two decades. "Labour inherited asonably strong economy whose tax regulatory systems were some- re between the relatively free erican model and the more inter- ionist Continental framework," says id B. Smith, chief economist at iams de Broë, a London brokerage. through a policy of stealth taxation egulation, Britain is moving closer rd Europe, and the result is British omic growth will head in the same ction as Germany's—down."

uch pronouncements may sound ex- ively dire, considering that the ish economy is holding up better most. Fueled by strong consumer and, growth is set to come in at this year, nearly double that on Continent. Inflation is low, and un- employment, at around 5.1%, is well be-

low the European average of 8.3%.

But scratch the surface, and it's clear that the economy isn't as robust as it looks. While it's true that the base tax rate for individuals and companies has fallen under Blair, the overall burden is rising. In 1996, public spending as a share of gross domestic product was 35%; by 2006, it'll reach 42%, says the CBI. "This government is taxing, spending, and failing," says Michael Howard, Conservative member of Parliament and shadow Chancellor of the Exchequer.

Blame it on Blair's ambitious and costly plans to shore up Britain's corroding public services, primarily the national health-care and education systems—something most British voters favor. To help plug the financing holes, the government has introduced a host of levies and hiked others. National insurance contributions, the local equivalent of the Social Security tax in the U.S., are set to rise by one percentage point in April for both employers and workers. Tax exemptions on dividend payments from pension funds have been scrapped. Coupled with a falling stock market, the tax changes threaten to trigger a pension crisis at many compa-

nies. The CBI estimates that increased taxes will cost businesses a total of \$74 billion between 1997 and 2005. "Tax competitiveness is a jewel in our crown, but it's starting to lose its luster," says CBI Director General Digby Jones.

The tax hikes are taking a toll on British corporate profitability: It has been falling for 13 quarters straight and shows no sign of picking up anytime soon, according to a survey by consulting firm Experian Business Strategies. Productivity growth has taken a hit, too: The annual rate has been halved, to 1.25%, since 1997. Unlike most economists, however, Chancellor Gordon Brown is betting on a strong recovery in economic growth—and corporate revenues. He expects growth to quicken to 3.4% in 2004, which is above the 2.7% independent analysts are forecasting.

Business leaders have another ax to grind. As Britain accepted the European Union's Social Chapter two years ago, companies will now have to comply with all of the employment and social regulations coming out of Brussels. These include restrictions on hours worked as well as proposed measures that would force companies to give temp workers the same benefits and rights as permanent staff. Another unpopular EU rule being debated: mandatory trade-union representation on corporate boards. The British Chambers of Commerce estimates the cost of complying with new regulations emanating from both London and Brussels at \$24 billion a year. "Britain will lose its flexibility and competitiveness as it moves closer toward Europe's restrictive work practices," warns Hugh Mathew-Jones, a partner at London accounting firm PKF.

Meanwhile, some businesses in Britain complain that if they are to shoulder the costs of EU membership, they should also be entitled to the benefits. Despite the economy's mounting woes, the pound has stayed stronger than the euro, hammering British exports. Carmakers are saying that if Britain does not adopt the euro soon, they may be forced to reconsider their British investments. Indeed, while Britain remains the No.2 destination for foreign direct investment worldwide, the country's share of global flows has dropped to 22%, from 39% in the 1990s. Tony Blair wants to make Britain more like the rest of Europe. If he's not careful, he may get just what he wants.

By Kerry Capell in London

but scratch the surface, and it doesn't look so robust

RUSSIA

'LIFE IS HORRIBLE'

There's little progress in reviving Chechnya's economy

It's hard to find a city more devastated, deserted, and dangerous than Grozny, capital of Russia's breakaway republic of Chechnya. Razed three times over the course of two wars fought between Russian federal forces and Chechen rebels since 1994, it's littered with land mines and ruins. Thousands of residents have fled, and those that remain live in half-destroyed apartment complexes, tending cows and other animals that wander around grounds planted with signs warning of active mines. Every few blocks, there are checkpoints manned by baby-faced Russian soldiers wearing black, fingerless gloves, the better to get a grip on their Kalashnikovs in case snipers attack. The city's name is disturbingly accurate: Grozny is Russian for menacing. (Ivan Grozny is called Ivan Grozny in Russian.) "Life is horrible," says Amina Tatayeva, 47, who works on economic development for the regional administration.

President Vladimir V. Putin wants to reintegrate this shattered land into Russia. The Kremlin is pumping as much as \$500 million in aid to the region. Putin even is calling for a referendum in Chechnya as early as March to vote on a new constitution for the republic that would certify its status as a permanent part of the Russian Federation. He also wants to end Chechnya's role as a redoubt for rebels and Islamic militants. That's especially urgent after the hostage crisis triggered by Chechen rebels in Moscow less than two months ago.

One sure way to dull the appeal of the rebel message is to revive economic life. Indeed, it should be better by now. After all, large-scale combat operations ended in

Chechnya two years ago and Russian troops control nearly all of the republic's territory.

Yet Putin's grand objective of moving Chechnya into the political and economic mainstream of Russia remains elusive. Locals still tend to resist Moscow's rule. Much of their resentment is driven by Russian so-called "zachistki" or "cleansing" operations in which raids on villages in search of rebels have sometimes been accompanied by raping and murdering of innocents.

The never-ending conflict is exacting a malignant toll on the Chechen people. Estimates of civilian deaths during Boris N. Yeltsin's first Chechen war, from 1994-96, range from 30,000 to 80,000, and there are no good estimates for civilian casualties in the current war under Putin. Another 70,000 Chechens are refugees. Federal officials assess the tab for Chechnya's reconstruction at \$2.7 billion, a number that seems too small given Grozny's near

total ruin. Yet Mikhail Babich, Moscow's newly appointed Prime Minister for Chechnya, insists that "reconstruction is in progress." Two water pumping stations in Grozny were restored this year, officials say.

The big question is how much of the aid will be productively spent. Embellishment schemes are flourishing. According to the Audit Chamber, a watchdog group that reports to the Parliament, contractors engaged to rebuild housing often submit inflated bills for their work. Ill-gotten gains are shared by corrupt bureaucrats and builders, leaving Grozny lined with apartment buildings listed as restored, but that in fact are uninhabitable.

Chechnya also suffers by being cut off from the market economy that is taking root in the rest of Russia. A 50-year-old bread factory outside Grozny remains under rigid government control, with the price of a loaf fixed at five Russian rubles, or about 15¢. A state radio station limps along with subsidies, but has not paid advertising. "What's the advertise—the war?" asks station director Anzor Davletukayev.

It need not be this way. In early Soviet times, Grozny was second only to Baku as an oil refiner. But now, the refineries barely work, according to Rosneft, the Russian state-owned company that holds licenses to develop Chechnya's oil reserves, estimated at 257 million barrels. Rosneft has its hands full extinguishing fires at sabotaged wells.

Not everything in Chechnya lies in disrepair. In Grozny, some 1,000 Russian soldiers reside at a refurbished base with a general store that assures they have ammunition, heat, hot water, and electricity. The soldiers collect twice the regular rate of pay plus a monthly bonus of \$645 for participation in active military operations. At a local cabin Russian Orthodox chapel on the base, the troops can say their usual prayers—and perhaps a prayer for their deliverance from a land of nightmares.

By Paul Starobin
Grozny



CHECHNYA'S ANGUISHED HISTORY

1991-1994 Soviet General Dzhokar Dudayev, a Chechen, takes power and declares independence. His regime becomes a center of narcotics and weapons trafficking.

1994-1996 In December, 1994, Boris Yeltsin invades Chechnya. After 10,000 troops are killed, Russian forces withdraw, and Chechnya wins de facto independence in August, 1996.

1997-1999 An Islamic warlord invades neighboring Dagestan in August, 1999, in hopes of creating a broader Muslim state. In September, 1999, Putin orders a new invasion by Russian forces.

2000-Present In October, 2002, rebels take 800 hostages in a Moscow theatre. Now, Putin is calling for a referendum, to draw up a new Chechen constitution.

THE NEW RANGE ROVER.

HIGHER GROUND.

What defines the evolution of a world-class vehicle? The ability to scale new heights. And when you experience the new 2003 Range Rover, getting there is as rewarding as being there. With a new cross-linked Electronic Air Suspension that provides unprecedented comfort and capability over almost any terrain. And the special alchemy of its luxurious waterfall-lit wood and leather interior that indulges the soul. No wonder *Car and Driver* magazine selected it "Best Luxury Sport-Utility Vehicle." The new Range Rover for 2003. From Land Rover. The most well-traveled vehicles on earth.



ANGE ROVER



THE LAND ROVER EXPERIENCE



AUTOS

NEGOTIATING EUROPE'S CURVES

Have the Japanese picked up Continental drivers' pulse?

When Nissan Chief Executive Officer Carlos Ghosn sets his targets, rivals take notice. The Renault veteran turned Nissan Motor Co. around in two years, transforming the once floundering Japanese group into the industry's most profitable carmaker after Porsche. But Ghosn (nickname: le cost-killer) needs new worlds to conquer. On Nov. 29, he flew to Nissan's Sunderland (England) plant as the first updated Micra minicar rolled off the assembly line. There he declared his new goal: boosting Nissan's car sales in Europe 20% by 2005. "We know it's extremely competitive, but Nissan is committed to the European market," Ghosn says.

Japan vs. Europe. It has long been heralded as the last great showdown in the car industry—an all-out assault by the Japanese on Europe, a rich territory jealously guarded by the local champions, who make most of the 15 million cars sold annually. So far, the Japanese have pushed their total share in Europe to just 11.5%—far below the 30% they command in the U.S. They can't even use quotas as an excuse for their performance—restrictions on Japanese

MICRA: Nissan is pinning its hopes on the soon-to-be-launched minicar



car imports to Western Europe were lifted in 2000. True, a steady drop in the value of the euro against the yen until this year also hurt. But European drivers have long found the styling of Japanese cars dull, the handling mushy, and the interiors plasticky. The Japanese also were unprepared for a surge in demand for fuel-efficient, diesel-powered cars.

But the Japanese refuse to give up. Equipped with stylish new models, diesel engines, and local partners, they're mounting a fresh challenge to Europe's auto makers. Take Toyota Motor Corp.'s \$9,290 Yaris subcompact, which has won rave reviews for its quirky styling, ample headroom, and short turning radius for exiting tight parking spaces. The car originally debuted as the Vitz model in Japan back in 1999. But it was designed in Toyota's European studio by a young, Greek-born designer named Sotiris Kivos, who formerly worked for France's PSA Peugeot Citroën. Toyota vehicles "have features the Europeans are copying, such as the elevated position of the seats in the Yaris that improve visibility, and all the interior storage spaces that women particularly like," says Peter Hudders, general manager of the Toyota City dealership in Brussels.

Nissan is pinning its European hopes on a small car, too—the Micra, which is built on a chassis the company will share with Renault, Nissan's leading shareholder. The new Micra offers better handling and rear seats that slide to of-

BRUSSELS SHOWROOM: Toyota's sales in Europe have grown 14% this year

fer more trunk space or legroom, and will be priced slightly lower than the current model, which starts at \$11,100. Ghosn plans to be selling 530,000 Nissan vehicles in Europe by 2005, up from around 470,000 this year.

Toyota's ambitions are even bigger. It wants to boost sales to about 1.2 million units from this year's 800,000, giving it a European share on a par with the powerhouses outside their home market. "I want us to become one of the [major] players, [with] say, 7% or 8% of the European market," says Tokuichi Ura, Toyota's managing director for Europe and Africa. This year, Toyota's sales have grown 14% in the European market, which is down 4% overall.

Higher sales are boosting bottom-line profits for the Japanese after years of losses in Europe. Toyota had a \$45 million profit in Europe for the six months ended Sept. 30, the first half-year profit since 1999, on \$6.2 billion in sales. Nissan earned \$5.8 million on revenues of \$1.1 billion. Third-ranked Honda Motor also is making a comeback. After losing its European market share for four consecutive years, it has rolled out two hi-

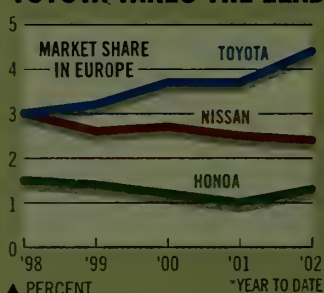
new Civic hatchback and the Jazz subcompact. Its sales in Europe are up 17%.

The next step for the Japanese will be to blunt a European counterattack. Volkswagen will roll out a new Jetta in 2003, and this version of the compact is expected to rack up huge gains. But by then, VW's new Golf is

on the road, the Japanese makers will be exploiting their European connections more aggressively than ever. Next year, Mazda, a subsidiary of Ford Motor Co., will produce a subcompact at Ford's plant in Valencia, Spain. Mitsubishi has teamed up with the Smart Div. of its German partner DaimlerChrysler to develop a four-seater minicar. The local heavyweights aren't panicking over the Japanese. But they're keeping a close watch on the rearview mirror.

By Christine Tierney in Frankfurt and Chester Dawson in Tokyo

TOYOTA TAKES THE LEAD



BusinessWeek online

For an interview with Carlos Ghosn, go to Dec. 16 issue online at www.businessweek.com.



Everyone's talking
about VIAGRA. Unfortunately,
not everyone knows
what they're talking about.

You've heard about VIAGRA (who hasn't?).
But did you know:

With VIAGRA, you can be in control.

VIAGRA doesn't give you an instant erection. It just allows you to respond to sexual stimulation. What's more, VIAGRA works in as little as 30 minutes and stays ready to work up to 4 hours. So you can enjoy intimacy when you both are ready.

With VIAGRA, you have a proven treatment.

VIAGRA works in 4 out of 5 men who use it for erectile dysfunction (vs 1 in 4 treated with a sugar pill). That's why **more than 9 million men** have already turned to VIAGRA.

To learn more, call 1-888-4VIAGRA or visit
www.viagra.com.

VIAGRA[®]
(sildenafil citrate) tablets

Join the millions. Ask your doctor if a free sample is right for you.

VIAGRA is indicated for the treatment of erectile dysfunction. Remember that no medicine is for everyone. If you take nitrate drugs, often used to control chest pain (also known as angina), don't take VIAGRA. This combination could cause your blood pressure to drop to an unsafe or life-threatening level.

Discuss your general health status with your doctor to ensure that you are healthy enough to engage in sexual activity. If you experience chest pain, nausea, or any other discomforts during sex or an erection that lasts longer than 4 hours, seek immediate medical help. The most common side effects of VIAGRA are headache, facial flushing, and upset stomach. Less commonly bluish vision, blurred vision, or sensitivity to light may briefly occur.

Please see patient summary of information for VIAGRA (25-mg, 50-mg, 100-mg) tablets on the following page.



PATIENT SUMMARY OF INFORMATION ABOUT

VIAGRA®
 (sildenafil citrate) tablets

This summary contains important information about **VIAGRA®**. It is not meant to take the place of your doctor's instructions. Read this information carefully before you start taking VIAGRA. Ask your doctor or pharmacist if you do not understand any of this information or if you want to know more about VIAGRA. This medicine can help many men when it is used as prescribed by their doctors. However, VIAGRA is not for everyone. It is intended for use only by men who have a condition called erectile dysfunction. **VIAGRA must never be used by men who are taking medicines that contain nitrates of any kind, at any time. This includes nitroglycerin. If you take VIAGRA with any nitrate medicine your blood pressure could suddenly drop to an unsafe or life threatening level.**

What Is VIAGRA?

VIAGRA is a pill used to treat erectile dysfunction (impotence) in men. It can help many men who have erectile dysfunction get and keep an erection when they become sexually excited (stimulated). You will not get an erection just by taking this medicine. VIAGRA helps a man with erectile dysfunction get an erection only when he is sexually excited.

How Sex Affects the Body

When a man is sexually excited, the penis rapidly fills with more blood than usual. The penis then expands and hardens. This is called an erection. After the man is done having sex, this extra blood flows out of the penis back into the body. The erection goes away. If an erection lasts for a long time (more than 6 hours), it can permanently damage your penis. You should call a doctor immediately if you ever have a prolonged erection that lasts more than 4 hours.

Some conditions and medicines interfere with this natural erection process. The penis cannot fill with enough blood. The man cannot have an erection. This is called erectile dysfunction if it becomes a frequent problem.

During sex, your heart works harder. Therefore sexual activity may not be advisable for people who have heart problems. Before you start any treatment for erectile dysfunction, ask your doctor if your heart is healthy enough to handle the extra strain of having sex. If you have chest pains, dizziness or nausea during sex, stop having sex and immediately tell your doctor you have had this problem.

How VIAGRA Works

VIAGRA enables many men with erectile dysfunction to respond to sexual stimulation. When a man is sexually excited, VIAGRA helps the penis fill with enough blood to cause an erection. After sex is over, the erection goes away.

VIAGRA Is Not for Everyone

As noted above (*How Sex Affects the Body*), ask your doctor if your heart is healthy enough for sexual activity.

If you take any medicines that contain nitrates—either regularly or as needed—you should never take VIAGRA. If you take VIAGRA with any nitrate medicine or recreational drug containing nitrates, your blood pressure could suddenly drop to an unsafe level. You could get dizzy, faint, or even have a heart attack or stroke. Nitrates are found in many prescription medicines that are used to treat angina (chest pain due to heart disease) such as:

- nitroglycerin (sprays, ointments, skin patches or pastes, and tablets that are swallowed or dissolved in the mouth)
- isosorbide mononitrate and isosorbide dinitrate (tablets that are swallowed, chewed, or dissolved in the mouth)

Nitrates are also found in recreational drugs such as amyl nitrate or nitrite ("poppers"). If you are not sure if any of your medicines contain nitrates, or if you do not understand what nitrates are, ask your doctor or pharmacist.

VIAGRA is only for patients with erectile dysfunction. VIAGRA is not for newborns, children, or women. Do not let anyone else take your VIAGRA. VIAGRA must be used only under a doctor's supervision.

What VIAGRA Does Not Do

- VIAGRA does not cure erectile dysfunction. It is a treatment for erectile dysfunction.
- VIAGRA does not protect you or your partner from getting sexually transmitted diseases, including HIV—the virus that causes AIDS.
- VIAGRA is not a hormone or an aphrodisiac.

What To Tell Your Doctor Before You Begin VIAGRA

Only your doctor can decide if VIAGRA is right for you. VIAGRA can cause mild, temporary lowering of your blood pressure. You will need to have a thorough medical exam to diagnose your erectile dysfunction and to find out if you can safely take VIAGRA alone or with your other medicines. Your doctor should determine if your heart is healthy enough to handle the extra strain of having sex.

Be sure to tell your doctor if you:

- have ever had any heart problems (e.g., angina, chest pain, heart failure, irregular heart beats, or heart attack)
- have ever had a stroke
- have low or high blood pressure
- have a rare inherited eye disease called retinitis pigmentosa

- have ever had any kidney problems
- have ever had any liver problems
- have ever had any blood problems, including sickle cell anemia or leukemia
- are allergic to sildenafil or any of the other ingredients of VIAGRA tablets
- have a deformed penis, Peyronie's disease, or ever had an erection that lasted more than 4 hours
- have stomach ulcers or any types of bleeding problems
- are taking any other medicines

VIAGRA and Other Medicines

Some medicines can change the way VIAGRA works. Tell your doctor about **any medicines** you are taking. Do not start or stop taking any medicines before checking with your doctor or pharmacist. This includes prescription and nonprescription medicines or remedies. Remember, VIAGRA should never be used with medicines that contain nitrates (see *VIAGRA Is Not for Everyone*). If you are taking a protease inhibitor, your dose may be adjusted (please see *Finding the Right Dose for You*). VIAGRA should not be used with any other medical treatments that cause erections. These treatments include pills, medicines that are injected or inserted into the penis, implants or vacuum pumps.

Finding the Right Dose for You

VIAGRA comes in different doses (25 mg, 50 mg and 100 mg). If you do not get the results you expect, talk with your doctor. You and your doctor can determine the dose that works best for you.

- Do not take more VIAGRA than your doctor prescribes.
- If you think you need a larger dose of VIAGRA, check with your doctor.
- VIAGRA should not be taken more than once a day.

If you are older than age 65, or have serious liver or kidney problems, your doctor may start you at the lowest dose (25 mg) of VIAGRA. If you are taking protease inhibitors, such as for the treatment of HIV, your doctor may recommend a 25 mg dose and may limit you to a maximum single dose of 25 mg of VIAGRA in a 48 hour period.

How To Take VIAGRA

Take VIAGRA about one hour before you plan to have sex. Beginning in about 30 minutes and for up to 4 hours, VIAGRA can help you get an erection if you are sexually excited. If you take VIAGRA after a high-fat meal (such as a cheeseburger and french fries), the medicine may take a little longer to start working. VIAGRA can help you get an erection when you are sexually excited. You will not get an erection just by taking the pill.

Possible Side Effects

Like all medicines, VIAGRA can cause some side effects. These effects are usually mild to moderate and usually don't last longer than a few hours. Some of these side effects are more likely to occur with higher doses. The most common side effects of VIAGRA are headache, flushing of the face, and upset stomach. Less common side effects that may occur are temporary changes in color vision (such as trouble telling the difference between blue and green objects or having a blue color tinge to them), eyes being more sensitive to light, or blurred vision.

In rare instances, men have reported an erection that lasts many hours. You should call a doctor immediately if you ever have an erection that lasts more than 4 hours. If not treated right away, permanent damage to your penis could occur (see *How Sex Affects the Body*).

Heart attack, stroke, irregular heart beats, and death have been reported rarely in men taking VIAGRA. Most, but not all, of these men had heart problems before taking this medicine. It is not possible to determine whether these events were directly related to VIAGRA.

VIAGRA may cause other side effects besides those listed on this sheet. If you want more information or develop any side effects or symptoms you are concerned about, call your doctor.

Accidental Overdose

In case of accidental overdose, call your doctor right away.

Storing VIAGRA

Keep VIAGRA out of the reach of children. Keep VIAGRA in its original container. Store at room temperature, 59°–86°F (15°–30°C).

For More Information on VIAGRA

VIAGRA is a prescription medicine used to treat erectile dysfunction. Only your doctor can decide if it is right for you. This sheet is only a summary. If you have any questions or want more information about VIAGRA, talk with your doctor or pharmacist, visit www.viagra.com, or call 1-888-4VIAGRA.

23-5515-00-4

June 1999

VIAGRA®
 (sildenafil citrate) tablets

EDITED BY ROSE BRADY

GERMANY: SCHRODER'S WOES COULD PARALYZE POLICY

German Chancellor Gerhard Schröder might be able to ignore the new hit rap song ridiculing him and his tax policy. He might be able to defuse the parliamentary committee looking into whether he deliberately misled voters at the state of public finances in his latest campaign. He might even be able to pooh-pooh calls by conservative leader Edmund Stoiber for new elections. But the one thing a seasoned politician such as Schröder can't ignore is poll results, and they couldn't be much worse.

Two months after voters narrowly gave Schröder a second four-year term, only 28% say they would vote for him again, according to Emnid, a polling outfit in Bielefeld. Half support the center-right Christian Democrats. In part, that reflects public anger at planned tax increases. But the underlying problem is credibility, pollsters say. Schröder's government didn't reveal the disastrous state of federal finances until after the election. To please unions, he reneged on promised labor-market reforms. Now, centrist voters no longer trust Schröder to tell the truth. "I've never seen any election where all the promises were kept, but this time the discrepancy was too great," says Torsten Schneider-Haase, Emnid analyst. "The loss of trust is irremediable."

Even for a comeback artist like Schröder, regaining confidence will be extremely difficult. The result could be policymaking paralysis. Businesspeople and ordinary voters alike are dismayed at what they see as lack of direction by the governing coalition of Social Democrats and Christians. The government plans, in effect, to raise business taxes by cutting deductions, while working people will pay more into the pension system. Germans could forgive those stopgap measures if they saw a strategy for getting the no-growth economy back on track. But most forecasters are pessimistic.

UBS Warburg, for example, expects growth of just 0.8% in 2003. "What is lacking is a vision," says Hubertus Erlen, CEO of Berlin drugmaker Schering.

Indeed, Schröder's standing has fallen so far that the weekly *Die Zeit* recently began an interview by asking him: "When are you going to resign?" Yet Schröder is unlikely to do so. And no one expects Schröder's left-leaning Green allies to desert the ruling coalition. Not since 1982 has a coalition fallen apart. "Schröder may be tarnished, but internally he can

still say: 'You don't have any alternative, so keep your mouths shut,'" notes Michael Greven, a University of Hamburg political science professor.

But that doesn't mean the Chancellor will recover the power he enjoyed in his first term. In fact, he seems to be handing the opposition Christian Democrats a golden opportunity to revive their strength. Polls show that Schröder's Social Democrats could lose control of Lower Saxony in February state elections. That would be a serious blow. Lower Saxony is Schröder's home state and has been under his party's control since 1990. A defeat there would solidify the conservatives' hold on the upper house of Parliament, which represents the states and can block major legislation.

Can Schröder fight back? He's trying once again to deploy his famed rhetorical skills, promising "comprehensive reform" of the social welfare system in a televised parliamentary debate on Dec. 4. But he offered few details, and that vagueness is likely to raise more questions among critics. "He has to give voters back some optimism in the future," says Stefan Bielmeier, a senior economist at Deutsche Bank. But it's hard to see how Germans can have faith in their country when they don't have faith in its leader.

By Jack Ewing in Frankfurt



SCHRODER: No credibility

GLOBAL WRAPUP

LULA HEADS FOR WASHINGTON

Brazilian President-elect Luiz Inácio Lula da Silva can expect a warm welcome when he visits Washington on Dec. 11, just three weeks before taking charge of South America's biggest economy. The Bush Administration is determined to forge a good working relationship with the leftist former labor leader because his support is key to the U.S. goal of creating a hemisphere-wide free-trade zone. Brazil and the U.S. are co-chairs of the next and final stage of negotiations for the

Free Trade Area of the Americas, which is to be launched by 2005.

But Lula is taking a tough line on the pact, accusing Washington of trying to dictate the rules. He's also angry over U.S. trade barriers to Brazilian agricultural and steel products. President Bush may find dealing with Brazil's feisty new leader no easy feat.

A REPRIEVE IN EGYPT?

► After more than a year in prison, American University in Cairo sociology Professor Saad Eddin Ibrahim, 64, was freed on Dec. 3, when Egypt's

highest appeals court ordered a January retrial. Ibrahim had been sentenced to seven years by a special state security court for "defaming Egypt" by disseminating information about problems between Egypt's Muslims and Christians and accepting European Union money to monitor elections without government permission.

The case had been taken up by human rights groups, and the U.S. had protested by threatening to block new aid to Egypt. Now, Ibrahim is hopeful that the retrial will acquit him and that he can return to his work.

AOL: ANATOMY OF A LONG SHOT

An inside look at how it developed a make-or-break broadband plan

Eight AOL Time Warner Inc. executives are huddled in a Dulles (Va.) conference room. The question: Should they banish obnoxious pop-up advertisements from the AOL site? America Online Inc. Vice-Chairman Ted Leonsis argues that pop-up ads should be snuffed out. They annoy subscribers, he says. AOL CEO Jonathan F. Miller sides with him. But Miller's boss, AOL Time Warner Chairman of Media & Communications Don Logan, defends the ads, which bring in \$100 million per year. Logan, says a source at the meeting, argues that while consumers gripe about these ads, they put up with them.

A nudge from AOL Time Warner

Chairman Stephen M. Case helps settle the matter. Case, who long held back from jumping into operational decisions at AOL, sends an e-mail to the group urging that they drop the ads. Case's name is mud among many Time Warner faithful, from executives at headquarters in New York to investors around the world. Since Case pushed through the \$100 billion merger of America Online and Time Warner, the combined company, battered by management turmoil and accounting scandals, has lost about \$40 billion in market value. But at AOL's headquarters in Dulles, the house that Steve built, Case still carries weight: The group moves to phase out pop-up ads.

Similar debates have been raging for months at AOL. Since Miller took command of the online business in August, he has been on a uphill mission to resurrect the company. This activity reached a fever pitch this autumn. From Sept. 19 to the New York unveiling of his new plan for AOL on Dec. 3, Miller led AOL executives on a forced march to remake the company—and he provided *BusinessWeek* with an inside look.

What emerges is a view of an iconic company navigating a frightening transition. Miller's troops have their backs against a wall. After weeks of debates, his team has concluded that the only real choice for the company is to plunge headlong in broadband. That's a world where even the basics, such as revenue and subscribers, are a big if.

The stakes are as big as the company itself. This has created a heightened sense of urgency, which is ushering striking cultural changes. Legions of AOL's true believers, folks who dream of a community of Netizens, have wrested control from the advertising faction long personified by Robert W. Pittman, the former AOL Time Warner chief operating officer who left under pressure in July. In this new climate, Steve Case, the original true believer, is a naturally welcome figure. He's more involved these days and is exerting far greater influence than outsiders think.

Miller's strategy, which he outlined before a crowd of analysts at the Shatton New York on Dec. 3, calls for creating compelling online offerings that will entice subscribers to stick with AOL when they graduate to broadband Internet access. It's an audacious plan.

AOL'S NEW STRATEGY

PLAN

IMPROVE CUSTOMER SATISFACTION:

As the stream of new Web users slows, AOL is focusing more on retaining customers than attracting new ones. It's losing those annoying pop-up ads, and it's sending free modems to some users with service-interruption problems.

BEEF UP PROGRAMMING:



It's lining up exclusive CNN videos and creating online comedy with HBO—plus creating its own programming.

PUSH BROADBAND SERVICES:

It's marketing a \$14.95-per-month online service to people who get their broadband access from others. It also sells a bundle of its services with broadband for \$54.95 a month.

SELL MEMBERS EXTRAS:

It will sell extra services, ranging from music subscriptions to multiplayer games, at monthly fees of \$2.95 to \$17.95.

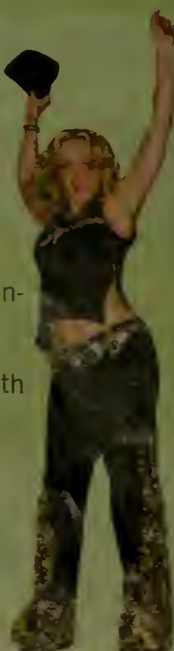
PROSPECTS

GOOD This isn't just happy talk. AOL is using analytical tools to figure out why people leave and is quickly fixing things.

FAIR AOL's Time Warner brethren control a trove of news and entertainment, but they haven't been cooperative in the past.

POOR AOL must come up with rich content to justify the extra fee above broadband access. Also, rival MSN charges less—\$9.95.

POOR Even though this strategy works in TV-land, it's unproven on the Web, where Netizens aren't used to paying for services.





THE QUIET EXECUTIVE

It's a gift from Steve Case: a big Hawaiian shirt hanging in Jonathan Miller's office. Case, the founding visionary, wears such things. Miller, 46, a soft-spoken executive brought in to rescue AOL, wouldn't be caught dead in one. He keeps his in a frame.

In a company molded by powerful personalities, Miller is a quiet anomaly. In small meetings at headquarters, he seeks consensus. At large gatherings, like the Dec. 3 unveiling in New York of AOL's new vision, he speaks stiffly.

Miller lacks charisma. But the Harvard University grad, who made his mark in e-commerce at USA Interactive, is brainy but approachable. Even as a high-paid commuter in New York, say friends, he lugged reading material in a white shopping bag. He's known as a listener, which should help him glean lessons from customers and colleagues.

That's already happening. A colleague's "eye-opening" talk sold him on a new broadband strategy, he says: "It pointed the way we had to go."

Now, Miller must make money on broadband, cashing in on Time Warner properties from Madonna to Tony Soprano. Maybe then he'll put on the Hawaiian shirt. Then again, maybe not.

...a long shot. To make it work, he has to bulldoze fiefdoms within Time Warner and to tap into that company's original exclusive programming, from CNN to new online comedy produced by Comedy Partners. The idea is to keep subscribers loyal and willing to pay extra for AOL's services even while subscribing to a rival company's broadband offering. "We had to measure ourselves by how many people we brought in the front door. That ends now," Miller said on Dec. 3. The new mantra: "increasing the lifetime value for customers."

AOL Time Warner is betting its future on that Miller's plan will pay off. True, forecasts flat revenues of \$9 billion next year, and a decline of 15% to 25% in this year's expected \$1.8 billion in earnings before interest, taxes, and depreciation. But in 2004, the company predicts, the new strategy will kick in to generate double-digit EBITDA growth. "This is not a wasting business," says AOL Time Warner CEO Richard D. Parsons. "In the next couple years, it's going to become the

FORCED MARCH

Miller had six weeks to get his troops out of the doldrums—and to change AOL's entire direction

growth driver for all of the AOL Time Warner businesses."

That's a tall order—so tall that many think the new strategy is doomed to fail. AOL is not only rushing pell-mell into a multimedia dream unproven as a business, it's also banking on promises of synergies that have crumbled before, undermined by powerful warring fiefdoms of the parent company. "It's a leap of faith," says John Tinker, media analyst at Blaylock & Partners LP. "They're throwing lots of stuff against the wall to see what works." Investors are skeptical, too: AOL's stock traded down 14%, to \$14.21, on Dec. 3. Even Case agrees that "none of this is a quick fix."

But if AOL defies the odds and latches on to a winning formula, it could sit atop the media world. In Net access, it still maintains a fourfold lead over No. 2

MSN, with its 9 million subscribers. But if AOL fails to free itself from its dial-up roots, the company could follow the path of Western Union, a communication titan from the telegraph age that was eclipsed by faster technologies.

AOL has little choice but to climb on the broadband wagon. The number of households with high-speed Net connections is expected to double to 32 million over the next three years, according to Jupiter Research. Yet AOL has lined up only 650,000 subscribers for its broadband package. And elsewhere, AOL must pay cable companies so much for each customer's access that they're left with thin margins. Worse, the company is losing some 200,000 subscribers per month to other broadband providers. And AOL's dial-up market is expected to start shrinking by the end of next year.

What will replace it? AOL plans to charge from \$2.95 to \$17.95 per month for a host of offerings. They range from phone services that electronically read e-mail to interactive shows featuring

the galaxy of Time Warner stars. The whole industry, from MSN to Yahoo, is chasing similar visions. But to date, premium services haven't sold. "It's going to be difficult when so much free stuff is on the Web," says Jupiter Research analyst David Card.

Miller, a former top exec at USA Interactive Inc., has a track record of Internet success. He lifted profits and growth at that company's ticketmaster.com and travel Web sites. But when he set a strategy meeting for Sept. 19 at AOL headquarters, he faced a far greater challenge.

Miller planned to give his top 35 execs the talk of a lifetime. He would let them know that it was up to them, over the following six weeks, to map out a future for AOL. Sure they were disheartened, but after two years of merger madness, infighting, broken promises, and stock options far under water, the company was theirs again.

The speech didn't go as planned. Miller emerged late from an AOL Time Warner board meeting in New York, and his corporate jet couldn't get him to Dulles in time. So as the managers munched on an austere spread of cheese, crackers, and celery sticks, Miller, from a runway at a Teterboro (N.J.) airport, talked to them on his cell phone. His voice

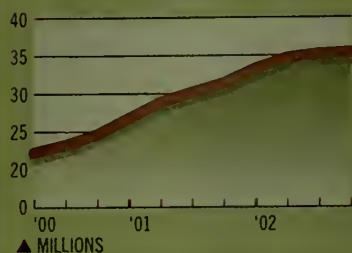
came through a single phone, and the execs craned to hear him as he appealed to their wounded pride: "We need to take back the right to define ourselves."

Miller's message worked a certain magic. For the next two months, the hallways of AOL, thumping to nonstop rock music, bustled with busy planners and programmers. Their days were endless, packed with arguments and the prospect of wrenching change. It was as if the entire company was going through therapy. It involved nothing less than stripping away the comforts of the past and groping for a new identity.

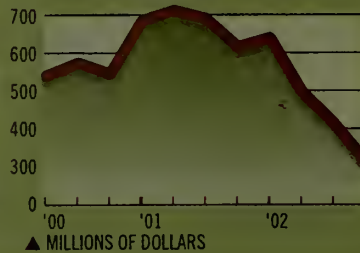
It started with a series of sprints.

THE SLOWDOWN HITS AOL HARD

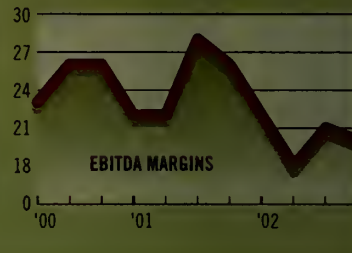
SUBSCRIBER GROWTH IS STALLING...



...AD AND COMMERCE REVENUES ARE PLUNGING...



...AND PROFIT MARGINS ARE DETERIORATING



Data: Company reports

Miller formed a steering committee headed by Leonsis, Vice-Chairman Joseph A. Ripp, Interactive Services President James de Castro, and AOL International CEO J. Michael Kelly to ride herd on 17 teams. Their first job? To answer within 10 days a mind-numbing 500 AOL questions assembled by Leonsis' pointman Dan Krifcher.

The goal was to have a new strategy ready for Miller to present at the board meeting, on Nov. 21.

Even before Miller joined the company, a grassroots back-to-basics movement was taking hold. Rebelling against the incessant bad news from Wall Street and the press, a band of midlevel managers in May started a morale-boosting campaign they called The Optimism Movement, plastering "Members First!" posters around the campus. So when Miller asked his troops to help him remake AOL, he had lots of supporters.

Of all the executives on Miller's team, AOL

Broadband President Lisa A. Hook had the biggest hurdle to clear. For years, AOL had offered its bring-your-own-access service for broadband customers. But the company resisted putting its marketing might behind the offering. It didn't want to cannibalize its massive dial-up access business. Now, Hook was arguing the opposite. One-quarter of AOL's defectors were switching to broadband connections from other providers. Hook recommended that AOL aggressively push a \$14.95-per-month service independent of AOL's access—in addition to offering \$54.95-per-month packages combining AOL and broadband connections.



TALL ORDER

Leonsis' committee had to answer 500 key questions about AOL in 10 days

Hook defended her broadband push with a sparkling vision. It was up to AOL, she said, "to recreate the dawn of television." But her ideas set off a firestorm. In subsequent meetings, steering committee member Kelly sharply questioned whether she was sidestepping the hard work of hammering out bundling deals with cable and telephone companies. "Sometimes you make decisions just because what you're doing is too hard," he said. Once again it was Chairman Case who weighed in, telling Miller he agreed with Hook. Kelly relented.

Still, a strategy based on content can collide with advertising. Longtime AOL manager James P. Bankoff learned this after he took over as chief of programming last June. It took him three tries before he made a presentation that satisfied Miller. At an Oct. 3 meeting, he stressed "monetizing" AOL Web pages by selling ads and encouraging visitors to make online purchases. But that's AOL old-think. At a second meeting, he argued for putting programming quality first. Better. And at a Nov. 7 meeting, he laid out a half-dozen areas in which to improve programming, including games and music. Miller approved.

Later, Miller asked his lieutenants AOL should have an editorial point of view—the way Fox speaks from the political right and CNN from the center. Leonsis said: "We would want to hold the mirror up to our membership"—which is conservative, closer to Fox politics than CNN's. Miller jumped in: "Then that would be our voice." But his team has yet to assess the risks of an editorial voice, or to figure out how to create one.

At this juncture, AOL's most important voice, Miller's, is busy telling the world that the company has a future in broadband. Miller had his forced march and he has his strategy. Now comes the big job: saving AOL.

By Catherine Yang in Dulles, Va.

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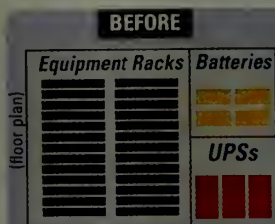
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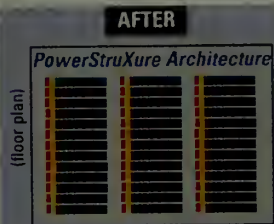
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BASKETBALL

THE WINNING WAYS OF THE NBA'S BAD BOY

The Mavs have been transformed under Mark Cuban

Maybe it's the abuse he hurls at referees. Or it could be his stint serving Dilly Bars at a Dairy Queen in Coppell, Tex. But around the NBA, Dallas Mavericks owner Mark Cuban has a reputation for behaving more like a fan in the nosebleed seats than the guy who owns the team.

"He's about as goofy an owner as I've been around," says Randy Galloway, veteran sports scribe for the Fort Worth *Star-Telegram*, who counts himself among Cuban's admirers.

Cuban, the billionaire co-founder of Broadcast.com, is still shaking things up. But his antics are a mere footnote to the real basketball story out of Dallas: This season, the Mavs are arguably the NBA's best team, outshining the Allen Iverson-led Philadelphia 76ers. After opening the season with 14 straight victories, they continue to pour it on. On Dec. 3, their 16-1 record led the league.

It's a far different team from the lame club Cuban bought from Ross Perot Jr. in January, 2000, for \$280 million, including an interest in the American Airlines Center. That squad hadn't posted a winning record in nine years and hadn't made the playoffs for a decade. The playoff drought ended two years ago, and now the club is red hot.

Cuban, of course, hasn't hit a free throw or drawn up a play—coach Don Nelson gets a wide berth to handle the X's and O's. And Nelson, who collaborates with Cuban on personnel, has made the most of a lineup led by deadly eye shooters including Michael Finley and international stars Dirk Nowitzki of Germany and Steve Nash of Canada.

But Cuban, 44, may be having the best season. Every time the team falters its lead in the standings, his quirky fix-it-now style looks a little more clever. Attendance is up 25% since Cuban bought the team, and the Mavs have had 38 straight home sellouts. On the road now, they're the NBA's No. 3 draw.

Cuban is the Mavs's cheerleader-in-chief and a swell sugar daddy. He shows up at practices, attends almost every game, and travels with the team. He foots the bill for eight assistant coaches—most teams have two—and a \$1 million Boeing 757 team jet, complete with training room and medical clinic.

Cuban wants motivated office workers, too, so he spends "a few hundred bucks" a month on massages for employees and a soda machine that dispenses free drinks. "We want [employees] excited to come to work, not dreading it," he says. He keeps up w



BUT WHAT DO YOU REALLY THINK?

Cuban has hurled abuse at refs for purported lax foul-calling—and has been fined more than \$1 million

rolls such as the Mavs's \$70 million-plus. But Cuban says it has had the unintended effect of rewarding teams that share in the penalty pool when his players are injured and new ones have to be signed. Without the tax, Cuban says, the Mavs would be at breakeven. With it, they will lose \$20 million this season.

Cuban, who's worth an estimated \$1.8 billion, says he'll absorb the losses. "To me, success isn't about how much money I have in the bank. It's how big a smile I have when I wake up."

Around the NBA, few officials see benefits to joining Cuban in a public debate. "I like Mark a lot. His ideas are terrific. But some folks—and I am one—would be even happier if he'd keep some of his terribly useful ones inside the tent instead of airing them publicly," says Atlanta Hawks President Stan Kasten.

Fat chance. Cuban figures to be just as outspoken when the season ends in June. If the Mavs are NBA champs, you might even hear his critique of the trophy.

By Mark Hyman

Mavs fans, too, trading notes with those who e-mail him at Mark.Cuban@DallasMavs.com. Often, Cuban steers such conversations to customer service: whether the usher was polite, whether the music was too loud in the arena.

Cuban and his fellow owners haven't always seen eye to eye, though. He has ranted against referees for purportedly officiating, and NBA Commissioner David J. Stern has hit him with more than \$1 million in fines—but failed to punish him. Last season, Cuban sentenced himself to a morning dishing ice cream after complaining that a league official didn't fit "to manage Dairy Queen."

Cuban has been quieter this year because, he claims, the officials are getting it right. "The easiest way to shut me up is to do something," Cuban says.

Maybe, but even owners who applaud Cuban's energy say he can talk too much. It irks some that he makes every perceived slight public. Any could be received quietly, they say, if Cuban worked thin channels.

That applies to Cuban's latest crusade: modifying the A's payroll tax. The league instituted the tax—which is likely to hit teams with payrolls above \$52 million—to discourage above-average pay-

NICE PERKS IF YOU CAN GET 'EM

How Mavs owner Cuban pampers players and workers

PLAYER PERKS

- Home team bench features specially designed chairs with back support and extra padding
- Each locker has a flat-screen TV, stereo, DVD player, CD player, and a PlayStation (locker room voted "best in the NBA" by *Sports Illustrated*)
- Postgame meals prepared by fine restaurants in Dallas
- Team travels on the Mavs's own Boeing 757

OFFICE-WORKER PERKS

- Free car washes, massages, Dairy Queen Dilly Bars, and a soft-drink machine that dispenses free sodas

AMD

me.

COMMENTARY

By **Ciro Scotti**

ALL THE AUGUSTA NEWS THAT'S FIT TO PRINT

In a year that has seen a terror-fighting President take America to the brink of war; that has seen the economy teeter and totter; that has seen Corporate America repeatedly revealed as a double-dealer; and that has seen the Democratic Party roundly humiliated, you'd think the country would have little time for a tempest in a golf cup over whether wealthy women should be admitted to a club where fat cats with sagging portfolios suck in their waists and try to hit a small white ball.

But the manufactured outrage over the gender-specific policies of Augusta National Golf Club apparently will not go away. On its face, that seems to be because Martha Burk, a feisty feminist out of Tyler, Tex., woke up one day and decided that what was going on at the home of the now-unfortunately named Masters Tournament was wrong, wrong, wrong, and she was going to right it.

Burk heads the National Council of Women's Organizations, an umbrella group that most people have never heard of and that claims to represent 6 million women. That put her in a position to exert some pressure—up to a point. Despite rancorous exchanges with Augusta Chairman William "Hootie" Johnson—recounted in the press ad nauseam—she got almost nowhere. Didn't move the leadership of the club an inch. Elicited no meaningful support from PGA Tour pros. Was given the silent treatment by the limo full of corporate CEOs who are members. Got shut out by the PGA. And was brushed off by CBS, which broadcasts the Masters. Augusta did suspend sponsors of the tournament, started by golfing god Bobby Jones, ostensibly to save Citigroup, Coca-Cola, and IBM from embarrassment.

Then, on Dec. 3, it was reported that Thomas H. Wyman, a former CEO of CBS, had resigned his membership in protest over the club's exclusionary policies. That may turn out to be a crucial victory. But for whom?

Burk's role as catalyst fulfilled, she has been sidelined—sort of like the Jerry Orbach detective in *Law & Order* after he has delivered the perp to the district attorney.

The case against Augusta is now being prosecuted by a power far more lethal than the NCWO and the righteous Ms. Burk. By now, Hootie and the other blowfish at Augusta surely realize that the barrel they are staring down belongs to *The New York Times*. Indeed, Wyman's resignation was first reported in a box on Page One of the *Times*, with a full story prominently displayed inside.

Since July, when the flap came to the fore, enough ink to fill Lake Titicaca has been spilled on the Augusta story. But no publication can match the newspaper of what seems like an endlessly re-playing record: At last count, the *Times* had run over 40 stories, columns, and editorials.

In mid-November alone, there was nothing short of

particularly repressive branch of the golfing set." That was in addition to five news stories. On Nov. 25, a Page One piece under the man-didn't-bite-dog headline "CBS Staying Silent in Debate on Women Joining Augusta" managed to bury the results of a *Times* poll indicating that "a plurality of Americans think it is unfair to force a private club to accept women." No mention was made of a Nov. 14 story questioning the validity of a poll commissioned by Augusta that came to much the same conclusion.

In an article about the *Times* in its Dec. 9 edition, *Newsweek* even suggested that the Southern populism of *Times* Executive Editor Howell Raines might be influencing coverage. Says Burk, who does not believe she has been supplanted as Augusta's chief adversary: "[*The Times*] has taken up the cause." Raines was unavailable for comment.

Whatever the motivation for the *Times*'s relentless attention, with Wyman's resignation, the ramparts have been breached. CBS has been shamed by its former chief. And current corporate bosses, forced by the realities of the labor market to encourage gender equality, diversity, and other socially liberal positions, will now have to do more than talk the talk. Unless the club

changes its policies, CEO members who don't walk the walk—out the door of the Alamo in Augusta—will have some explaining to do to *The New York Times*.

With Susann Rutledge in New York

With *The New York Times* on his back, Hootie Johnson is up against a power far more lethal than a feminist gadfly

Hootie-mania in its pages. A column by Dave Anderson began, "Hootie Johnson keeps asking for trouble," a column by Robert Lipsyte tried to explore the mind of Hootie, and an editorial called Hootie "the poster boy for a



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EDITED BY LARRY ARMSTRONG

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Products of 2002



STRAIGHT SHOOTER

The buzz in golf circles this year is over Callaway's reinvention of the lowly putter. The **ODYSSEY WHITE HOT 2-BALL** (\$170) has two golf-ball-size white disks atop its head that help golfers line up a straight path to the hole (800 228-2767, callawaygolf.com).



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X

THIS JAGUAR PURRS

Apple Computer's **OS X** operating system has a half-finished feel to it when it was released last year. The newest version, called **JAGUAR**, reestablishes Apple as a leader in software design. It restores the simple networking that has been a Mac hallmark, and makes it easier for Macs and Windows PCs to work together (800 697-apple.com).

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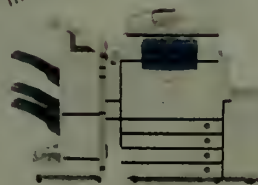


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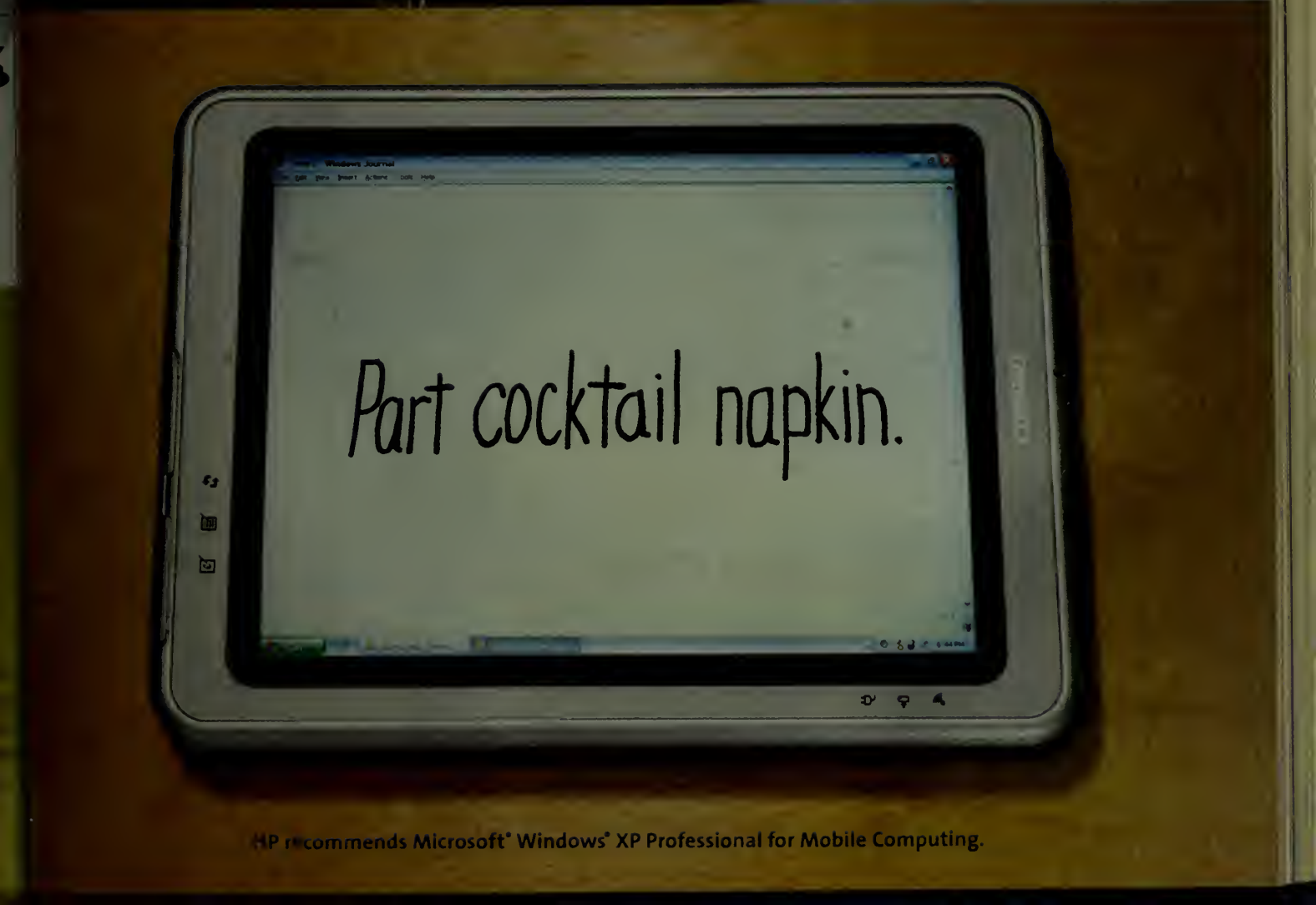


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A person's hand is visible on the left, reaching towards a small HP laptop sitting on a wooden shelf. The laptop screen displays the text "Part laptop." in a handwritten font. The laptop is silver and has "Compaq" written on the right side of the bezel.

Part
laptop.

A close-up of an HP tablet lying flat on a wooden surface. The screen shows a "Windows Journal" window with the text "Part cocktail napkin." written in a cursive, handwritten font. The tablet has a silver bezel and a small HP logo on the right side.

Part cocktail napkin.

HP recommends Microsoft® Windows® XP Professional for Mobile Computing.

WARM WELCOME

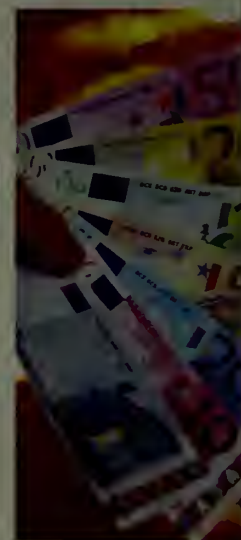
More and more car alarm systems come with remote starters, a hot item in cold climates.

AUDIOVOX's APS996 (\$500 installed) goes the next step: Its two-way remote control reports the vehicle's interior temperature back to you on a tiny LCD display on your key chain (800 645-4994, www.audiovox.com).



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Number 28

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BOTTOMS UP

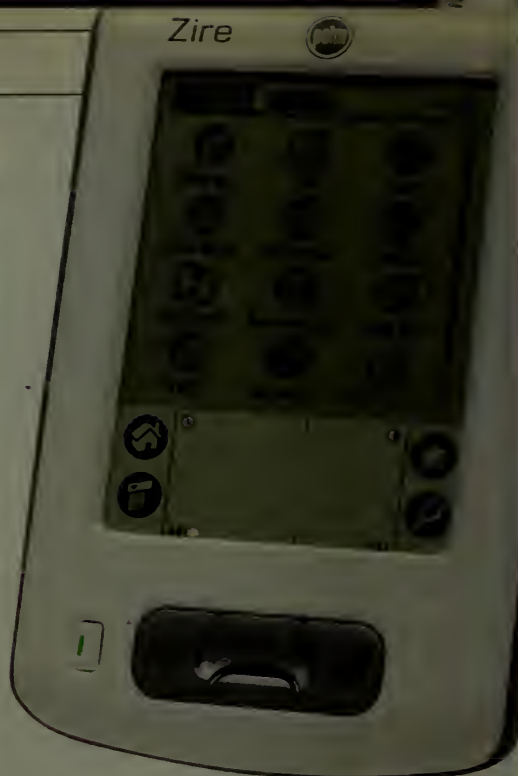
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The all-new 2002 **HONDA INTERCEPTOR** (\$9,999) picked up its advanced technology from Honda cars. Variable valve timing gives the V-4 engine more grunt at the low end, more oomph at the top, while optional antilock brakes and saddlebags make the sport bike a pleasure to ride (310 532-9811, hondamotorcycles.com).



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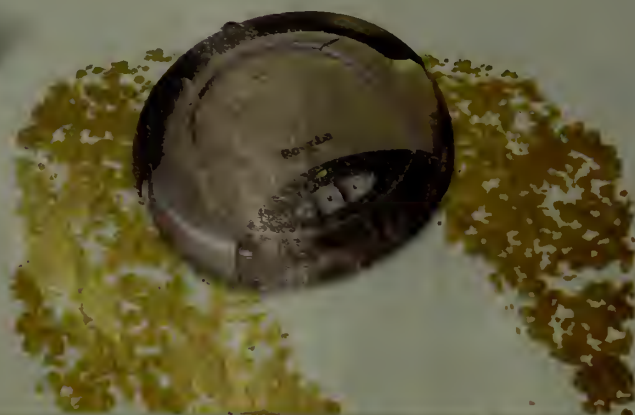
POCKET SHOOTER

Thin is in for digital cameras, and none is more innovative than Minolta's 2-megapixel **DIMAGE X** (\$350). An elegant touch: Its 3X zoom lens moves entirely within the camera body (877 462-4464, minoltausa.com).



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ROOMBA (\$200), a light-duty vacuum from iRobot, can negotiate its way around a room on its own, sweeping and sucking up little messes in its path (866 476-6622, roombavac.com).



PRODUCTS TO WATCH

Will price-sensitive American consumers take to cell phones with built-in digital cameras, a runaway hit in Asia? The U.S. just got its first, a \$400 Sanyo phone from Sprint, and models from **NOKIA** and Sony Ericsson will follow early next year. Carriers want to bill their customers a few bucks per megabyte for sending photos and data, but Sprint has already backed off and charges a flat \$10 monthly fee.



Toyota invented its new Scion brand to sell wild cars to Gen Y drivers who won't consider buying what their



parents buy. The **SCION BBX**, along with a second model, will arrive in California dealers' showrooms in June, and in 2004 for the rest of the country. But can a company as staid as Toyota come up with enough wacko models to keep Scion alive?

Microsoft's Tablet PC version of Windows is undeniably a



(ATTENTION)



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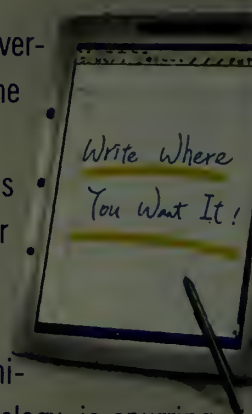
Energizer® e2[®] batteries are built with Titanium Technology™ and advanced cell construction so they last longer in your power-hungry, high-tech devices. And the longer they last, the longer you play.

*vs. prior e2[®]; industry standard high-tech tests average

PRODUCTS TO WATCH

cool idea, although the company's first run at it has lots of rough edges. Nevertheless, the software, which uses a stylus or pen and handwriting recognition technology, is spurring some badly needed innovation in the design of laptops, tablets, slates, and hybrids by such companies as Hewlett-Packard, Fujitsu, Toshiba, and **ACER**.

■ Late to the SUV party, the jointly developed, similar-looking sport wagons from



Volkswagen and Porsche could raise the bar for "sport" in sport-utility vehicle. Porsche's Cayenne will come first, offering up to 450 horsepower good for 165 mph. The Volkswagen **TOUAREG**, named after a nomadic Sahara tribe, will follow in June. It will be tamer but still quick and agile. And at \$37,000, it will cost \$20,000 less. Buyers will vote: prestige or price.

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there was a company in danger
of getting left behind. Customers
were demanding more service. Customization.
More value. So they bought a Time Machine. Flick a switch,
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weren't connected. They couldn't share
information about their customers. They couldn't
communicate inside of *their own* four walls. So they bought a
Universal Business Adapter (UBA). The box said that it could "connect anything
to everything." There were prongs for e-mail. Payroll. Servers. It could make the
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MANAGEMENT

NOW IT'S GETTING PERSONAL

Companies drill down on employee data to zero in on perks that spur the most productivity

Imagine that your company's human resources department does away with standard salaries, one-size-fits-all benefits, and the usual raft of yawn-inducing seminars. Instead, HR execs huddle over computer programs that slice and dice data on you and your cube-mates—controlling for age, tenure, educational background, commute time, residential Zip Code, even the age and condition of the office you work in. The aim is to predict your behavior, ascertaining exactly how to cut costs without sabotaging morale—as well as which incentives would spike your productivity the most. Could they pay you 20% less but give you a three-month sabbatical every two years, cementing your allegiance and jolting your output? If they dumped your 401(k) match, would you bolt from your job or barely notice? Does your boss's managerial touch inspire you or undermine your ability to produce? And what if, instead of parking you in a lecture in some stuffy hotel ballroom, you got a customized seminar that unleashed your ability to lock in 20% more in annual sales?

This may seem the stuff of corporate sci-fi—but it's actually here. A growing vanguard of HR heads are quickly embracing a new discipline, human capital management, that attempts to capture new gains from workers just as Six Sigma squeezed new efficien-



employers can customize compensation minutely, but that could draw legal challenges

cies from factories. Some of the most groundbreaking work is coming from Mercer Human Resource Consulting, which is pioneering its new statistical modeling technology with clients including Quest Diagnostics, FleetBoston Financial, and First Tennessee. These kinds of analyses are helping a lengthening list of blue chips figure out exactly what kind of a return on investment they are getting from the millions

of dollars they spend on their work forces. "This is the new thinking in the new HR," says Kurt Fischer, vice-president of HR at Corning Inc. "Here's what we're spending. What are we getting for it?"

Caught in the profits crunch, companies crippled by anemic growth are desperate to energize earnings. Labor costs, which account for an average 60% of sales, represent a huge opportunity. Instead of placing precise bets on what compensation mix or management approach would work best, companies have usually thrown "everything at the wall, ratcheting things up slowly every year and hoping some of it works," says Dave Kieffer, head of Mercer's human capital group. When companies make cuts, just as much guesswork—and potential for backlash—comes into play. With the new technologies, companies can now accurately measure the ROI of their people.

The new human capital frontier is fraught with challenges, though. Critics worry that customizing the workplace so minutely could create a new office Darwinism that makes free agents of everyone, with little common ground and no ability to, say, collectively bargain. More specifically, employers' ability to sift through the employee ranks by neighborhood or educational level could lead to legal objections, especially when it comes to rewarding

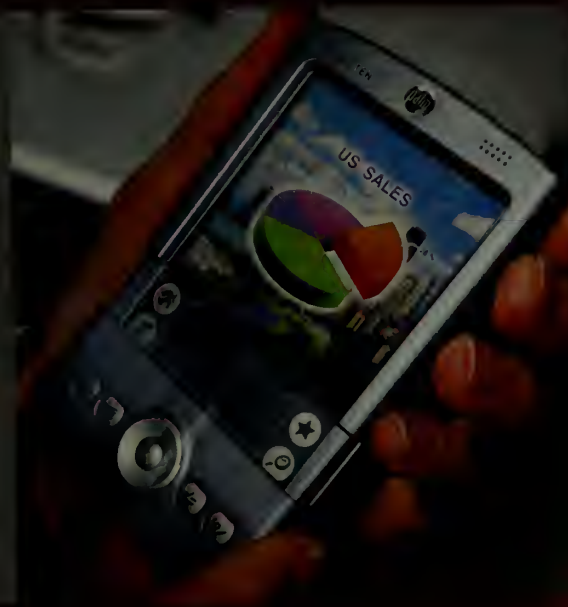
TAILOR-MADE

Using new tools,

or penalizing people differently. So far, most of the new HR has focused on employee groups, not individual workers. But experts say that grinding down to the personal level is only a matter of time. "This will likely breed greater inequality, even for people in the same educational cohort," says Peter Cappelli, management professor at the University of Pennsylvania's Wharton School. "It raises big philosophical ques-



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tions as to whether people are motivated by differences in treatment and whether we are going too far down the road of individual differentiation."

The growing interest in the new human capital metrics stems from a rejection in some quarters of benchmarking—the practice, promoted by many big consulting firms and management gurus, of aping the best-performing companies such as General Electric Co. and Microsoft Corp. The result has been a cascade of CEOs copying everything Jack Welch and Bill Gates did—with many of them failing. Some developed a mania for rank-and-yank performance reviews, without ascertaining if tenure actually enhanced productivity. Others adopted flexible, just-in-time workforces that they could switch off and on like a spigot, without assessing the drag on productivity part-timers could cause.

The perils of this kind of blind benchmarking were evident at one major hospital chain, where the CFO bragged that his aggressive use of part-timers was saving the company \$5 million a year. Each time the CFO found a rival with a lower ratio of full-timers, he would ax more at his own hospitals—to the point where one facility was being run by a staff of 80% part-timers. Not surprisingly, those employees were often clueless about local hospital practices and wound up wasting the time of the full-time staff. What Mercer's analysis showed was that the use of so many

part-timers was actually costing the company \$25 million in reduced productivity—3% of annual revenues. By hiking the ratio of full-timers back up to 63%, the chain regained 18% in overall productivity within two months.

This points to one big difference between the new human capital management and old-era HR: Instead of looking

dark side of these tools: providing cover for what's essentially brutal cost-cutting. "Historically HR has wanted to be the equality police," says Mark Husel, a Rutgers University HR strategy professor. But now there's a danger that brass could misuse the data in the process, "creating a monster," says

Michael Scofield, a senior vice-president

workforce consultant Nuclius Solutions.

Still, the new human capital initiatives can provide valuable insight. After studying its rank, First Tennessee realized that bank customers reacted more favorably to experienced employees than it did to new hires. That means that no matter how many college grads the bank hires, nor how many experienced pros it brought in, it could not beat the tens of millions more in annual sales it could reap merely by increasing retention of current workers

THE INTERNAL LABOR MARKET

THE OLD HUMAN RESOURCES APPROACH

- Pay is based on salary grades and hourly rates
- Bonuses tied to unit and company performance
- Benefits are standard throughout organization
- Management strategy modeled on best practices at high-performing companies
- Career structures are predetermined

THE NEW HUMAN CAPITAL MANAGEMENT

- Pay is based on achieving goals
- Bonuses tied to individual performance
- Benefits tailored to employee groups
- Strategy based on internal analysis of employees
- Career structures are sculpted to individuals

Data: BusinessWeek, Mercer Human Resource Consulting

outside to others for cookie-cutter answers, the new thinking argues that it's better to look at the company's internal labor market. One blue-chip beverage maker assumed its longest-tenured drivers were the most productive. After a time-series analysis—controlling for factors such as older drivers getting their pick of the best routes—the company realized that once its drivers hit the nine-year mark, productivity plummeted even as their pay rose. In this case the company reassigned the drivers to less physically taxing jobs. But another company may have been more cold-blooded and fired them. It shows the potential

by at least one year.

In another such analysis, a blue-chip technology company learned that its pay structure was penalizing the highest performers and rewarding the weakest; lackluster employees were clustered in a cash-cow unit, while superstars were toiling in a still-profitable upstart division. "Most companies are just cutting without this kind of analysis," says Kieffer. That's not likely to last, as more and more businesses realize how much they're spending on something about which they know so little.

By Michelle Conlin in New York

THE END OF ONE SIZE FITS ALL?

Get ready for the next wave of pay for performance. In January, Gateway Inc. jettisoned its annual bonus payouts based on performance grades (ranging from 1 to 5). Instead, the struggling computer maker is doling out bonuses quarterly that hinge more directly on individual achievement. At Sysco Corp., incentive pay for managers, drivers, and loaders is tied to whether the right products get delivered at the right time, with no dented cans or

torn bags. And at Nationwide Insurance, some bosses will see their bonuses battered if underlings anonymously report that they are 5% less happy working for the company this year than they were last. Think of it as a kind of piece-rate pay, updated for the 21st century.

The new compensation schemes enable companies to transform pay from a fixed to a more flexible cost, blowing the cover off coasters and letting stellar players reap outsize rewards. But

dangers loom: In the custom-built workplace, managers can play favorites. Teamwork can implode. And workers subjected to uneven treatment can bristle. What is to keep bosses from increasing demands so that the only way to make the mortgage payment is to work more hours?

What's clear, though, is that the new compensation is slowly erasing the idea of one size fits all. Instead of a relatively collective workplace, a new era is approaching in which people working alongside one another doing the same jobs could have wildly different deals.

By Michelle Conlin in New York

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THE FUTURE OF THE FED

Alan Greenspan has guided the U.S. through boom and bust. A new debate over policy is just beginning

By Rich Miller

Is the glass half full or half empty? The last couple of years have been tough for the U.S. economy and for Federal Reserve Chairman Alan Greenspan. A shallow recession has been followed by a recovery that still shows few signs of taking off. Greenspan has sounded oddly uncertain about the economy's direction: "This is one of the most difficult periods of forecasting we have confronted," he told economists in London on Sept. 25.

That's a sobering admission from a man who became a national icon in the 1990s. In his 15 years as head of the Fed, Greenspan has presided over a period of strong growth, low inflation, and low unemployment (charts, page 96). And he has managed numerous crises—from the stock market crash of 1987 to the terrorist attacks of 2001—remarkably well.

Beyond that, Greenspan became the quintessential New Economist, the man who correctly foresaw that information technology was spurring faster productivity growth, enabling the U.S. economy to grow more rapidly without inflation than anyone had thought possible. It was Greenspan who gave the economy room to run when the conventional wisdom dictated tightening to ward off inflation that never came. The result was the sort of prosperity not seen for a generation—strong business investment, higher wages, and a soaring stock market—benefiting millions of Americans. Even after the sharp sell-off on Wall Street, stock prices as measured by the Standard & Poor's 500-stock index are

twice as high today as they were when the boom started in early 1995. And the productivity revolution that Greenspan correctly heralded continues even in the current sluggishness, much to the surprise of most economists.

But if Greenspan deserves credit for the productivity-driven boom, he is also vulnerable to criticism for the bust that took place on his watch, particularly in the tech and telecom sectors. The NASDAQ index is down 71% from its high in March, 2000, and the dot-com era is remembered mostly for its excess and folly. Deflation is a threat for the first time in 70 years, and the labor market can't muster a sustained recovery. Many fear that Greenspan may be running

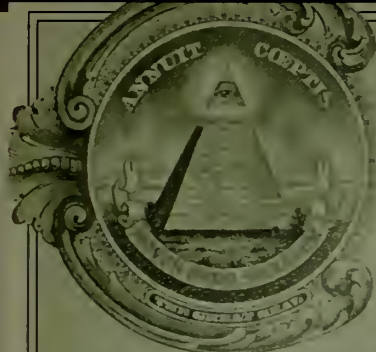
out of policy options to deal with today's problems. Even the Nov. 6 rate cut—which took short-term rates down to 1.25%, the lowest since 1961—may not be enough

Cover Story

to repair the damage wrought by the bursting of the stock market bubble and the uncertainty engendered by the threat of terrorism and a potential war with Iraq. "We're fighting some pretty powerful forces," one Fed official says.

At stake here is more than just academic arguments over Greenspan's legacy. What matters most is the future of Federal Reserve policy.

Why? Because Greenspan, in formulating his strategy, developed an approach to monetary policy based on the observation that the economy is always evolving in response to changes in technology, regulation, and other factors. That means monetary guidelines that are useful at one moment may need replacing. Greenspan is convinced that the Fed has learned to identify quickly changes in the way the



GREENSPAN CORRECTLY FORESAW THE PRODUCTIVITY REVOLUTION THAT LET THE U.S. GROW FASTER WITHOUT IGNITING INFLATION . . .

economy works by monitoring a wide array of published data and real-time information—and by modifying its forecasting models accordingly. The result is a monetary policy that changes as the economy's structure changes.

If Greenspan is right, this approach represents an enormous advance in central banking, which historically has been based on either fixed rules or seat-of-the-pants policymaking. It would also be a major step forward compared with traditional economic forecasting models, which have often missed big shifts in the economy.

In particular, the way we think about asset markets may need to change. Greenspan believes the stock bubble may be a side effect of a successful monetary policy. That is, when the central bank can stamp out inflation and reduce the risk of recession, it encourages investors to take more chances with their money. This can lead to boom-bust cycles in asset markets—but it may also mean more capital spending and innovation and bigger productivity gains. Financial volatility may go along with good policy and strong long-term growth, just as athletes are more prone than couch potatoes to suffer certain types of injuries.

Whether or not Greenspan is right in the long run, the economy's recent troubles are strengthening the hand of critics who would change the Fed's direction after his departure—likely in 2004. While the Fed leader is still widely admired within the bank, his colleagues seem less willing to defer to his judgment than when he was at the height of his intellectual influence in the late '90s. At the Fed's Sept. 24 meeting to set rates, two policymakers openly broke with Greenspan's decision to hold policy steady, the first time in four years that there has been such dissent. Publicly, there's also far more discussion of the possibility that monetary policy during the boom ended up worsening the bust.

As the successes of the 1990s become clearer, support for Greenspan's flexible brand of New Economy monetary policy is weakening among bank policymakers and leading outside economists. Ra-

ther than being held up as a model for future generations, central bankers, Greenspan may be viewed less favorably. Thus the next Fed chairman may be less willing to adapt to a changing economy than Greenspan was—and less willing to emphasize growth.

That's likely to mean a central bank that is quicker to raise interest rates once the economy picks up steam, more hesitant to risk letting unemployment decline as low as 3.9% it reached under Greenspan, and less inclined to have the U.S. economy serve as the engine of global growth.

Two different visions of the post-Greenspan Fed are emerging: the "inflation-targeting" school, led by new Fed Governor Ben S. Bernanke, an economist from Princeton University, and the "anti-bubble" school, advocated by Stephen P. Chetty, former research director of the Federal Reserve Bank of New York and now an Ohio State University economist.

LOOKING BACK THE LEGACY

How Alan Greenspan's track record so far stacks up against the two other great chairmen in Federal Reserve history



ALAN GREENSPAN
1987-present



PAUL VOLCKER
1979-87



MARRINER ECCLES
1934-48

INFLATION
ENTERING OFFICE*
LEAVING OFFICE**

3.5 1.8

GROWTH RATE OF
PERSONAL CONSUMPTION
DEFLATOR, IN PERCENT

7.2 3.5

6.6

-4.7

UNEMPLOYMENT

7.7 4.2

AVERAGE UNEMPLOYMENT
RATE, IN PERCENT

7.1 7.9

19.0 2.1

Data: Bureau of
Labor Statistics S&P

*AVERAGE FOR FIVE YEARS BEFORE BECOMING

... BUT AS THE EXCESSES OF THE 1990S BECOME CLEARER, SUPPORT FOR HIS NEW ECONOMY MONETARY POLICY IS WEAKENING



Supporters of "inflation targeting," who also include another former New York Fed research director, Frederic S. Mishkin of Columbia University, agree that Greenspan has been a great central banker. But they think the Fed's main aim should be to control inflation. Some worry that Greenspan creates confusion when he testifies to Congress about the importance of growth and productivity. "Inflation—it's the one thing they can control, and should control," says Robert E. Lucas Jr., a Nobel prize-winning University of Chicago economist. In this view, the Fed should just stick to its knitting. The inflation targeters want the next Fed chairman to announce a target range for inflation publicly and then regularly report to Congress on how well the Fed has met that goal. The advantage of inflation targeting is that it reduces uncertainty. Consumers and businesses would know that if inflation rose above a set level—say, 2%—the central bank would act to cool

off growth. The inflation targets would also ensure that the Fed would boost the economy if inflation fell too low and became deflation, which is today's main worry.

Other influential voices are arguing that the Fed needs new monetary-policy rules—not only for inflation but also to moderate financial-market excesses. The "anti-bubble" economists, including Cecchetti and longtime Wall Street guru Henry Kaufman, say that Greenspan got it wrong in the '90s by allowing the stock bubble to distort the economy. Among the first to warn of the dangers of the market bubble was Lawrence B. Lindsey, now President George W. Bush's economic adviser. In the fall of 1996, Lindsey, then a member of the Fed's board, called behind the scenes for higher rates to control the "irrational exuberance" that Greenspan would warn about just two months later. In the end, however, Lindsey deferred to the chairman and voted to hold rates steady. In retrospect, former associates say, he believes the Fed should have raised rates modestly. "The Fed should have done more to prevent the financial-asset bubble," agrees William C. Dudley, chief economist at Goldman, Sachs & Co.

Cover Story

ALAN GREENSPAN

PRODUCTIVITY



RATE OF NONFARM PRODUCTIVITY, IN PERCENT

STOCK MARKET



ANNUAL PERCENT GROWTH RATE OF S&P 500 DURING TERM IN OFFICE

GREENSPAN'S ACHIEVEMENTS...

- Presided over the longest U.S. peacetime expansion, which saw unemployment fall to its lowest level in a generation
- Conquered inflation, achieving the Fed's long-cherished goal of price stability
- Perceived the acceleration in productivity growth in the mid-1990s and correctly concluded that the economy could safely grow at a faster rate
- Managed monetary policy to smooth the impact of negative shocks, such as the 1987 crash, the 1997 Asian financial crisis, the 1998 Russian debt default, and the 2001 terrorist attack

...AND SHORTFALLS

- Allowed a stock market bubble to take hold in the late 1990s, and this later led to the market bust
- Ran a highly flexible monetary policy, which may be difficult for successors to emulate
- Supported the idea of multiyear tax cuts in 2001, risking big budget deficits after years of fiscal discipline

A key member of this school is Andrew Crockett, general manager of the Bank for International Settlements, the central bankers' club in Basel, Switzerland. He argues that financial bubbles can lead to economic instability, with hard-to-control deflationary consequences. Hard-core anti-bubble types want the next chairman to act against excesses in all asset markets, such as an unwarranted run-up in stock prices, a housing bubble, or even an overvalued currency.

The future of the Fed will largely depend on who is chosen as the next Fed chairman. Greenspan's fourth four-year term ends just months before the Presidential election in 2004. While some speculate that Greenspan might stay on beyond that date to avoid enmeshing the appointment of his successor in election-year

FOR LAST FIVE YEARS OF TERM AS CHAIRMAN
S TO PRESENT FOR GREENSPAN



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GREENSPAN THINKS A GOOD MONETARY POLICY ENCOURAGES PEOPLE TO TAKE RISKS, WHICH MAY LEAD TO A STOCK BUBBLE



politics, he is clearly nearing the end of his career. So far, no obvious successor has emerged. The early favorite, monetary economist John B. Taylor, has not impressed the financial markets with his performance as Treasury Under Secretary for International Affairs. Bush adviser Lindsey has lost favor in his struggle to manage the President's fractious economic team. And with Wall Street hit by scandals, the financial sector is not likely to produce a credible candidate any time soon.

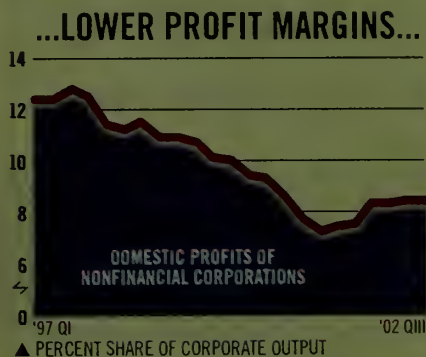
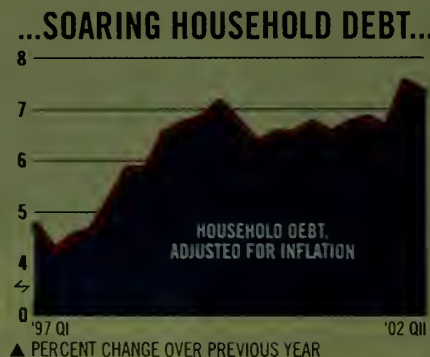
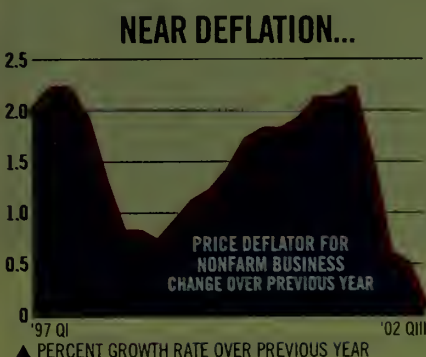
If the economy weakens, President Bush might lean toward appointing a Fed chairman who would give growth a boost. Such a move would be especially tempting if Greenspan stepped down before the 2004 elections. That would argue for someone like Dallas Fed President Robert D. McTeer, a strong proponent of the productivity-driven New Economy. The White House has not yet shown its hand by word or deed. Bush's appointments to the Fed board so far have been strong centrists, and Greenspan is known to be delighted that the President has shied away from using his appointments to the Fed for political purposes.

Nevertheless, both the inflation targeters and the ant bubble economists have been actively proselytizing. Since his appointment as Fed Governor in August, Bernanke has informally talked to a number of the members of the Fed, the main policy arm, the Open Market Committee, about the need to set public inflation targets.

Greenspan and his supporters in the bank, including William J. McDonough, head of the New York Fed, Roger V. Ferguson, vice-chairman of the Fed, and Donald L. Kohn, newly appointed to the Fed board, staunchly defend the chairman's brand of central banking. While the Fed watches prices very closely, Greenspan has resisted explicit inflation targeting because he believes that the changing nature of the economy makes it hard to pin down exactly what inflation goal is appropriate. Worse, formal inflation targeting risks tying the hands of the Fed chairman in the event of unexpected shocks. "If we have something like September 11 happen again, I sure wouldn't want to be caught having to think about a price-stability target when the main thing you're trying to do is restore public confidence," one policymaker says.

THE PRESENT PROBLEMS, PROBLEMS

To encourage a recovery that shows few signs of taking hold, the Fed must address:



Data: Bureau of Labor Statistics



THE S&P IS STILL AT TWICE ITS 1995 LEVEL



s. After the terrorist strikes, the Fed flooded the financial system with funds, providing much-needed liquidity. And Greenspan has been unwilling to commit the Fed to using monetary policy to intervene in asset markets, even those that seem wildly out of whack. In an August speech at a Federal Reserve conference in Jackson Hole, Wyo., Greenspan argued that "it was far from obvious that bubbles, even if identified early, could be preempted short of the central bank inducing a substantial contraction in economic activity—the very outcome we would be seeking to avoid." Greenspan is also undoubtedly mindful of the historical record, which shows that the Fed has courted disaster when it has tried to broaden its mandate to include the stock market. In the late 1920s, Board Governor Adolph Miller led a concerted campaign to rein in high-flying stock prices. The eventual result was that the Fed tightened monetary policy in 1928 and 1929, even though inflation was nil. The perverse move helped trigger the stock market crash of October, 1929. Moreover, the Fed did not move aggressively enough to cut rates after the crash, setting the stage for the decade-long Great Depression.

Faced with an investment boom and a stock market bubble reminiscent of the 1920s, Greenspan followed a different strategy. He elected instead to ride the runup in the stock market, believing this would be better in the long run than prematurely pricking the bubble by jacking up interest rates. Once the bubble burst, however, he acted swiftly to limit the impact on the real economy, cutting interest rates 11 times in 2001 in the fastest credit-easing campaign in the Fed's history.

Bernanke shares Greenspan's reluctance to restrain rapidly rising asset markets. Even such stock market bears as Robert J. Shiller, the Yale University economist who has consistently argued that stocks are overvalued, agree with Greenspan and Bernanke that raising rates in the 1990s could have proved disastrous. "If they had raised interest rates to burst the bubble," says Shiller, "they could have tanked the economy."

Still, Shiller and other economists believe that the Fed had ways of acting against the stock mania, short of raising rates. For example, increasing the cost of buying stocks on credit by lifting margin requirements would have helped, posits Shiller, although only a limited number of investors would have been affected.

"Like putting warning labels on liquor bottles," says Shiller, it would have been a signal from the Fed to investors that they should be more wary. Alice M. Rivlin, a Brookings Institution economist who was vice-chair of the Fed from 1996 to 1999, agrees. "The one thing I regret is that I didn't push harder for raising margin requirements," she says.

Former Fed Governor Janet L. Yellen points out that Greenspan could have used his influence to get that point across as well. After he was attacked for warning of the dangers of irrational exuberance in 1996, he mostly stayed away from the topic. "I wish he had continued to talk

Cover Story

LOOKING AHEAD WHAT'S NEXT?

Here are the three schools of monetary policy vying for primacy in the post-Greenspan Fed:

A 'NEW ECONOMY' FED

OBJECTIVE Hold down inflation while encouraging growth

ADVANTAGES Promotes prosperity while encouraging growth; enables Fed to identify economic changes and adjust policy accordingly; gives the central bank the flexibility to respond to economic shocks

DISADVANTAGES Encourages excessive risk-taking; sows confusion about Fed's aims; makes a resurgence of inflation more likely

PROPOSERS WITHIN THE FED

■ Alan Greenspan, chairman
■ Donald L. Kohn, governor

PROPOSERS OUTSIDE THE FED

■ Alice M. Rivlin, former Fed vice-chair
■ Janet L. Yellen, former Fed governor

AN 'INFLATION-TARGETING' FED

OBJECTIVE Keep the economy on course by setting a target range for inflation and sticking with it

ADVANTAGES Cements Fed's credibility as an inflation fighter after Greenspan leaves; makes central bank more open and accountable

DISADVANTAGES Reduces Fed's flexibility in managing the economy and responding to financial crises; potentially inhibits growth

PROPOSERS WITHIN THE FED

■ Ben S. Bernanke, governor
■ J. Alfred Broaddus, Richmond (Va.) Fed president

PROPOSERS OUTSIDE THE FED

■ Frederic S. Mishkin, former New York Fed research director
■ Alan H. Meltzer, Carnegie Mellon University professor

AN 'ANTI-BUBBLE' FED

OBJECTIVE Hold down inflation while acting to restrain runaway asset markets

ADVANTAGES Curbs financial excesses; short-circuits booms

DISADVANTAGES Puts Fed in the position of second-guessing financial markets; potentially crimps economic growth

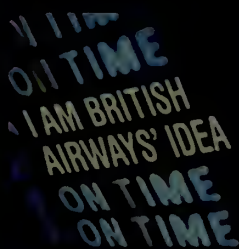
PROPOSERS WITHIN THE FED

None who will admit it

PROPOSERS OUTSIDE THE FED

■ Stephen G. Cecchetti, former research director at the New York Fed
■ Andrew Crockett, general manager, Bank for International Settlements
■ Henry Kaufman, economic consultant

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about it," says Yellen. For his part, Greenspan doubts public jawboning is useful unless it's backed up by higher interest rates.

Privately, associates say that Greenspan's objection to reining in the runaway stock market was political as well as economic. He thought the central bank lacked the mandate to act, and he worried that raising rates to restrain the bubble could have

caused a political backlash that compromised the Fed's cherished independence.

History, however, shows that the Fed's mandate evolves over time. For example, the emphasis on inflation fighting—which today is integral to the Fed's mission—didn't take hold until soaring prices and a falling dollar forced President Jimmy Carter to appoint Paul A. Volcker as Fed chairman in 1979.

Similarly, the events of recent years are pushing Greenspan to take more account of financial markets. He realizes that as wealth rises faster than income—as it has over the past 20 years—the asset side of the nation's balance sheet becomes more important.

The wild card in the debate over the future of the Fed, of course, is what happens in the next couple of years. If the U.S. economy and stock market bounce back quickly, Greenspan and his forward-looking approach will look a lot better. If today's slump continues, the next Fed chairman will be tempted to do something rather different.

There's a third possibility: If the economy stalls and fears of deflation increase, the Fed will feel pressed to rev up short-term growth by any means available. The danger: If prices and incomes start falling, the financial system could seize up. Borrowers would find it harder to pay back debts, and banks would be unwilling to lend money at near-zero interest rates. Moreover, the Fed's usual policy tools for boosting growth would become less effective. Typically, the Fed combats recessions by trying to create so-called negative real interest rates—rates below the level of inflation—to induce skittish consumers and companies to borrow and spend more. But if inflation is negative, that strategy won't work, and the economy could fall into a downward spiral.

The prospect of deflation has already altered the attitudes of anti-inflation hawks such as Richmond (Va.) Federal Reserve President J. Alfred Broadus. "I've spent most of my career focused on reducing inflation," he said in

a speech earlier this year. "[But now] I've become more conscious of the kinds of policy problems that can arise in a low-inflation, low-interest-rate environment, especially when the economy softens."

Still, Fed policymakers are confident—cautiously so—that the U.S. can avoid the fate of Japan, which seems stuck in a deflationary trap. Greenspan, for one, believes that a lot of Japan's problems are cultural and structural. In a society that prizes consensus, Japanese authorities have not taken the tough steps needed to overhaul the country's banking sector.

Moreover, should deflation hit and U.S. short-term interest rates fall to near zero, Greenspan and other members of the Fed have said that they are ready to take unconventional policy measures. "There's a general view that as the federal funds rate gets to zero, we are out of business," Greenspan told the Council on Foreign Relations on

November 19. "That is not the case." Among the potential strategies: buying long-term bonds to drive long-term interest rates down and purchasing foreign currencies to lower the dollar's value. In theory, such measures could stimulate growth. For example, a lower dollar should boost exports. But in practice the Fed has far less control over long-term interest and exchange rates than it does over short-term interest rates.

Another concern, both inside and outside the Fed, is the value of the dollar. Some Fed officials suspect the dollar is overvalued: They liken it to the pre-crash stock market. They worry that the dollar-driven trade deficit is unsustainable in the long run and will eventually lead to a disruptive plunge in the dollar. But Greenspan and his supporters don't see what they can do about the dollar's value short of driving the economy into recession and drastically reducing

America's demand for imports. So they've adopted the same approach that they used for stocks: Wait—and be prepared to act quickly to limit economic fallout should the dollar suddenly collapse.

In the end, Greenspan's legacy will be judged by how the economy does in the next couple of years. A weak performance will tarnish the gains of the 1990s and cause people to back away from Greenspan's strategy of a flexible monetary policy and his espousal of a high-growth, high-risk economy. But if growth picks up and the stock market recovers, which many economists expect, then Greenspan's vision of the future will prevail—and the chairman would go down in history as the best central banker ever.

Cover Story

WHO WILL BE THE NEXT CHAIRMAN?

At 76, Greenspan is near the end of his career, but there's no clear front-runner. Monetarist JOHN B. TAYLOR's performance as Treasury Under Secretary hasn't wowed the markets. Dallas Fed President ROBERT D. McTEER has the backing of some Bush cronies, but he may lack the needed expertise. A possible compromise: Harvard's MARTIN FELDSTEIN, an adviser to Bush on the campaign trail



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YEAR OF THE WHISTLEBLOWER

When Martin L. Grass, the former Rite Aid Corp. chairman and CEO, was indicted in late June along with three other company managers, prosecutors tipped their hats to Joe Speaker—a little-known executive at the drug-store chain. Soon after becoming acting chief financial officer at Rite Aid in 1999, Speaker uncovered numerous errors in the company's accounts. He told Grass that the problems were serious enough to require a major restatement but feared the CEO would brush them aside. At the time, the Camp Hill (Pa.)

company desperately needed to raise capital to pay debt from an acquisition spree. Grass was pleading with banks to extend a line of credit while trying to persuade the Securities & Exchange Commission to stop holding up a share offering.

What the then 40-year-old Speaker did next went beyond the call of duty. He contacted and personally hired Ralph C. Ferrara, a former SEC general counsel recommended by his brother Pete, a lawyer. Ferrara arranged a private meeting with Rite Aid's audit committee, led by Loews Corp. Co-Chairman Preston R. Tisch. Days later, the brothers drove to a secret Manhattan meeting.

Over the next several hours, the acting CFO nervously relayed an incredible story of accounting chicanery. Inventories had been overvalued, bills were being paid out of reserves set aside to close stores, and millions in expenses had not been properly booked. According to one person present, he warned: "I'm in over my head." Stunned, Tisch and other board members, including former Primerica Corp. Chairman Gerald Tsai Jr. and Hartz Group Inc. Chairman Leonard N. Stern, authorized him to hire whatever help he needed to dig into Rite Aid's books. In the end, \$541 million in earnings over the previous nine quarters became \$1.6 billion in losses.

Speaker will be a main government witness when Grass and three lieutenants go on trial early next year. All four have pleaded not guilty. A Rite Aid spokeswoman declines to comment. Speaker, son of a former Pennsylvania attorney general, also won't discuss his role in stopping what prosecutors say was one of the most audacious capers in corporate history. "Joe is an ordi-

nary man who was put in an extraordinary position," says his lawyer, Philip S. Khinda. "And he responded in just the way we all hope we would."

This year, dozens of ordinary people have been put in extraordinary positions throughout Corporate America, and like Joe Speaker, they blew the whistle. Some are now familiar names, such as Enron Corp.'s Sherron S. Watkins (page 110) and WorldCom Inc.'s Cynthia Cooper. But most are middle managers who want to avoid the limelight. Behind the scenes, they have all played a critical role in providing en-

forcers with virtual road maps around complex accounting maneuvers. "Whistleblowers give us an insider's perspective," says Linda Chatman Thomsen, the SEC's deputy director for enforcement, "and have advanced our investigations immeasurably."

It would not be too glib to call 2002 the Year of the Whistleblower. The spectacular blowups at Enron and WorldCom have sensitized employees to

the devastation caused by corporate crime. That has helped create a "do the right thing" culture in which employees believe they have little choice but to ring the alarm when they suspect misconduct, despite potentially high personal costs. Watkins and Cooper have helped recast whistleblowers from crackpots to national champions, says Stephen Meagher, a former federal prosecutor who represents whistleblowers. "The business of whistleblowing is booming," he says.

More important, the landmark Sarbanes-Oxley Act of 2002 gives those who report corporate misconduct sweeping new legal protection. An executive who retaliates against a corporate whistle-

The personal costs are high, but a new law protects truth-tellers as never before

Legal Affairs

blower can be held criminally liable and imprisoned for up to 10 years. That's the same maximum sentence a mafia don gets for threatening a witness. The Labor Dept. can order a company to rehire an employee without going to court. And fired workers who feel their cases are moving too slowly can request a federal jury trial after six months. "This is a revolution in corporate free speech," says Louis A. Clark, executive director of the Government Accountability Project, a Washington watchdog group that helped write the law. "It's hard to overestimate its impact."

Companies must rethink how they deal with whistleblowers and revisit a wide range of policies. They need to rewrite nondisclosure pacts, meant to keep company secrets inviolate, to differentiate whistleblowing from leaking. And they may no longer be able to enforce rules requiring

employees to get permission to speak to the media or lawmakers. Even layoffs

Legal Affairs

must be planned so they are not seen as retaliatory.

Corporate lawyers also have special responsibilities under the new law. If they come across evidence of misconduct, they must report it to top management. If there is no response, the lawyer must report higher up the line, to the board. The aim is to prevent lawyers from sitting idle—and claiming attorney-client privilege—when they see laws broken.

As a result, many executives will have to be coached on the whole phenomenon of whistleblowing, not unlike the sexual harassment training of a decade ago. "You're going to see [corporate] policy changes that set the stage for cultural changes," says John D. McMickle, a lawyer who represents whistleblowers at Chicago's Winston & Strawn.

But these changes aren't going to come quickly—and they certainly aren't going to turn whistleblowing into a fast route to fame and fortune. In the movies, corporate truth-tellers are rewarded for their agonies with vindication. Jeffrey Wigand, the tobacco researcher who revealed that Brown & Williamson Tobacco Corp. knew tobacco was addictive (played by Russell Crowe in *The Insider*), got to see the industry brought to its knees. The heroes of *Silkwood* and *The China Syndrome* pay with their lives, but their dire warnings of the dangers of nuclear power turn out to be justified.

Movies, however, are made only about the precious few with appealing stories. For many, whistleblowers, tattling on the boss still means career suicide—with no applause. Indeed, half of the 200 respondents to an August survey by the National Whistleblower Center in Washington said they were fired after reporting misconduct. Those not canned often face retaliation, such as being demoted to a lesser job. If they leave, they are often blackballed in their industry. "Whistleblowers are like a skunk at a picnic," says Senator Charles E. Grassley (R-Iowa),



a long-time advocate of their cause in Congress. "There's greater peer pressure to get along in any organization."

Ask Judy Collins, who was recently terminated from her job as a regional director of marketing for homebuilder Beazer Homes USA Inc. Just six weeks after joining the company in March, she alleges she came across financial irregularities as well as efforts to intimidate employees who raised questions. Two weeks after laying out her complaints in an e-mail to the company president, she was fired, she says, for "personality conflict." Beazer spokesman Ron Warren says the company will not comment on her charges.

Collins says she is now unemployable since her accusations have gotten around. By going public, she may have gone from a gadfly at one company to a perceived troublemaker. The entire home-building industry now shuns. "I've gone in four and five interviews in some cases," she says, "but

WHISTLEBLOWER CHECKLIST

Experts say anyone thinking about tattling on their company should ask themselves four important questions before doing so:

IS THIS THE ONLY WAY?

Do not blow the whistle unless you have tried to correct the problem by reporting up the normal chain of command and gotten no results. Make sure your allegations are not minor complaints.

DO I HAVE THE GOODS?

Gather documentary evidence that proves your case and keep it in a safe place. Keep good notes, perhaps even a daily diary. Make sure you are seeing fraud, not merely incompetence or sloppiness.

WHY AM I DOING THIS?

Examine your motives. Do not act out of frustration or because you feel underappreciated or mistreated. Do not embellish your case and do not violate any confidentiality agreements you may have.

AM I READY?

Think through the impact on your family. Be prepared for unemployment and the possibility of being blacklisted in your profession. Last but not least, consult a lawyer.

Data: BusinessWeek



ING UP

on exec Watkins (left) change the image of te whistleblowers. (above) claims she was off the fast track at after telling superiors recasts were inflated. Crossing tried to dis- accounting whistleblow- on's (right) allegations



er get the job." The Labor Dept. is investigating her ms—not to pass judgment on their validity but to deter- ne if they were the reason for her termination.

Other whistleblowers have endured campaigns of public hu- liation. Consider Roy L. Olofson, a former finance vice-pres- nt at Global Crossing Ltd. In August, 2001, five months be- e the company went bankrupt, he sent a letter to its top ics official alleging that the telecom swapped fiber-optic ca- pacity with other carriers to artificially boost revenues. He was off three months later. The SEC and the Justice Dept. are estigating his charges, but that hasn't stopped Global's attack Olofson's credibility. It claims he sought a large payment in change for his silence. Olofson refuses to comment, but on pt. 24, he gave the House Energy & Commerce Committee eek into the tortured life of a whistleblower: "Television ws lurk at our front door...Global Crossing and its PR ma- ne have accused me of being a disgruntled employee...and airman of the Board Gary Winnick [stood] up in front of the ire office and [called] me an extortionist." Global says his job was part of a companywide reduction.

So if blowing the whistle is akin to *hara-kiri*, why do so ny do it? There are almost as many reasons as there are stleblowers. Some, like Richard D. Parks, an engineer n Grass Valley, Calif., are by-the-bookers. These are peo- highly steeped in a particular discipline, from engineering accounting to medicine, who take an almost personal of- se when professional standards are compromised.

n the 1980s, Parks became something of a *cause célèbre* in fledgling whistleblowing movement. With two colleagues, alleged that Bechtel Group Inc.'s cleanup after the Three e Island nuclear-power-plant disaster was faulty. He was pended by Bechtel, then reinstated once multiple federal ncies exonerated him. But he was given a new job about far from civilization as you can get—a natural-gas plant on

the edge of Death Valley. After six months, his job was eliminated. The whole experience, he says, was "hell." Bechtel says Parks's charges were without merit.

Now, he has done it again. In March, Parks filed suit against L.S. Starrett Co., maker of devices that test parts for planes and other complex machines. Parks charges that Starrett, for whom he worked as a subcontractor, tried to conceal from customers such woes as defects in operating software. His charges were bolstered by a Pentagon investigator in an affidavit unsealed on Nov. 6 in U.S. District Court in Greensboro, N.C. A Starrett spokesman denies the charges as "untested hearsay allegations." What makes Parks go to all the trouble? "I've asked myself that many times," Parks says.

Another type, the self-protectors, know about problems that could lead to an investigation. They might even be responsible for some of them. By coming clean, they clear their consciences—and lessen the likelihood of going to jail. That may explain the actions of Rite Aid President Timothy J. Noonan, who wore a wire and recorded Grass allegedly plotting to foil the grand jury investigation. On one recording, Grass is quoted as saying that investigators would never get hold of a computer containing evidence that he backdated letters "unless they use a Trident submarine." On July 10, Noonan pleaded guilty to withholding information from investigators. In exchange for his cooperation, prosecutors are expected to seek probation. Noonan, through his lawyer, would not comment.

Then there are the corporate outliers, people who just don't fit into the culture of the company. Many women working in an environment dominated by men are in this category. Watkins and Cooper, for instance, both worked in macho cultures.

Whatever category they fall into, whistleblowers are going to find life a bit easier. Under the Sarbanes-Oxley law, they need only make a disclosure—to a supervisor, law-enforcement agency, or congressional investigator—that could have a "material impact" on the value of a company's shares. The Labor Dept. is responsible for investigating claims of whistleblowers who say they have been terminated, demoted, or harassed. So far, 16 people have filed complaints.

Sarbanes-Oxley could also

A STRONG NEW LAW

Employees of publicly traded companies are now the most protected

whistleblowers. Provisions co-authored by Senator Grassley in the Sarbanes-Oxley corporate-reform law:



GRASSLEY

► Make it unlawful to "discharge, demote, suspend, threaten, harass, or in any manner discriminate against" a whistleblower

► Establish criminal penalties of up to 10 years in jail for executives who retaliate against whistleblowers

► Require board audit committees to establish procedures for hearing whistleblower complaints

► Allow the Secretary of Labor to order a company to rehire a terminated whistleblower with no court hearings whatsoever

► Give a whistleblower a right to a jury trial, bypassing months or years of cumbersome administrative hearings

Data: BusinessWeek

HOLLYWOOD'S LOVE AFFAIR WITH WHISTLEBLOWERS

On the silver screen, they're always vindicated—even if only posthumously

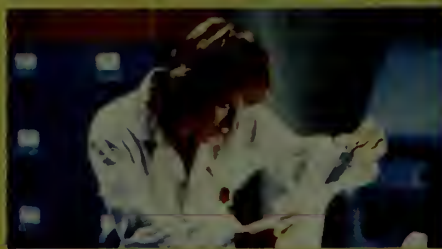
THE CHINA SYNDROME (1979)

JACK LEMMON's character warned of dangers at a nuclear plant



SILKWOOD (1983)

Karen Silkwood, played by **MERYL STREEP**, died mysteriously



THE INSIDER (1999)

Big Tobacco is skewered by Jeffrey Wigand, played by **RUSSELL CROWE**



rescue some complaints that used to fall by the wayside. Christine Casey, for instance, claims she left her financial-analyst job at Mattel Inc. in 2000 after being pushed aside by supervisors as punishment for pointing out what she believed to be intentionally inflated sales forecasts. Her wrongful-termination suit, filed under

a California whistleblower law, was thrown out of Los Angeles

County Superior Court in September because, the judge said, Mattel did not fire her. Under the new law, though, the mere allegation of retaliation would have triggered a review. Mattel says it has nothing to add beyond the judge's decision. Casey, who is appealing, says her fast-track career may have been permanently stalled by her choice to speak up.

Legal Affairs

There are critics who say the law doesn't go far enough. Their main beef: Unlike those who expose government fraud, there are no financial incentives for corporate whistleblowing the new law. Nor does the act cover private companies. But while the law isn't perfect, Congress for the first time has erected a protective shield around employees who ring the alarm. Corporate managers had better brace themselves.

By Paula Dwyer and Dan Carney, with Amy Borrus and Lorraine Woellert in Washington and Christopher Palmeri in Los Angeles

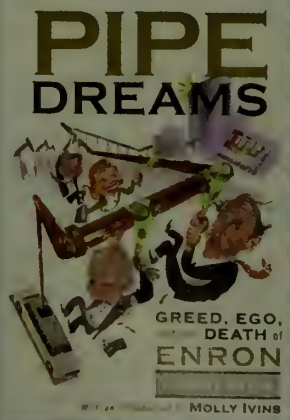
BusinessWeek online

For more on Grassley and whistleblower sites, go to the Dec. 16 issue online at www.businessweek.com

WAS SHERRON WATKINS REALLY SO SELFLESS?

Whistleblowers have none other than Sherron S. Watkins to thank for the new coat of armor Congress gave them in the new Sarbanes-Oxley law. That's ironic, given that the former Enron Corp. vice-president has never fit neatly into the whistleblower mold. Indeed, the woman made famous by her August, 2001, warning to Chairman Kenneth L. Lay is facing some revisionist criticism of her role at the company.

Watkins, 43, is getting heat for not taking her concerns about accounting and insider deals to regulators, the press, or even the company's board. As Lay attempted to investigate her claims, she was selling some \$48,000 worth of stock—for tax and diversification reasons, her lawyer says. Journalist Robert Bryce, in his book *Pipe Dreams*:



Greed, Ego and the Death of Enron, portrays her as an overeager climber looking to grab a more important job by getting Chief Financial Officer Andrew S. Fastow fired.

One company exec even notes that

Watkins failed to raise any red flags in 1999 when she was trying to sell Enron's stake in a Caribbean power plant to an off-balance-sheet partnership run by Fastow. The deal ultimately fell through, but "not due to any lack of effort on her part," says the source. The partnerships later played a significant role in undermining investor confidence.

Watkins, who would speak only through her lawyer, Philip Hilder, insists she did not know the disturbing details that set off alarm bells for her until 2001. When she wrote her memo, she was simply trying to save

Enron before it was too late. Says Hilder: "She acted entirely appropriately. She went to the management that she thought would rectify the problem in-house and did what a good employee should have done. It took moxie and courage."

However history judges Watkins' role in the Enron charade, her story directly influenced Congress as it considered whistleblower protections. The revelation that Enron considered firing Watkins once she revealed that she was the memo's author angered legislators. So they made sure to strengthen anti-retaliation protections in the law.

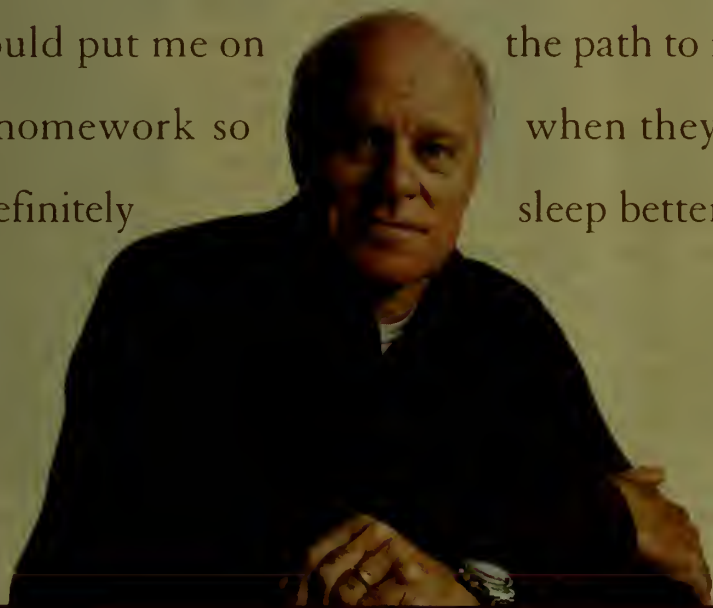
Watkins recently left her \$165,000-a-year Enron job of her own accord when she found herself with little to do at the bankrupt company. But she leaves a big mark. Faced with Enron-like misconduct elsewhere, says a former Enron employee, "we'll be much more assertive. We'll not be intimidated." That's a legacy no revisionism can take away.

By Wendy Zellner in Dallas

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RESEARCH

ANALYSTS WHO GET IT

A few are willing to rile companies—and investment pros love them

PacifiCare Health Systems Inc.'s stock had been a loser for years. The Cypress (Calif.) health-maintenance organization was mired in an accounting scandal; Medicare plans were siphoning profits; and top management had bailed. "Everything about the company was horrible," says Michael W. Green, a money manager for Moody, Aldrich & Sullivan LLC in Marblehead, Mass. A former highflier that hit \$93 in 1999, it had plunged as low as \$10.

But in late October, Green had a change of heart. He bought \$5 million worth of shares after getting a hot contrarian tip from Kevin P. Lane, chief market strategist at Technimentals Research Group, an independent research firm in New York. Lane said the new chief executive, Howard G. Phanstiel, had cleaned house, and the company had turned profitable. Hardly anyone on Wall Street had noticed. All but one of the 14 analysts covering the company had a sell on it. The next week, the stock soared 40% when PacifiCare surprised analysts by more than doubling third-quarter profits. Green now expects the \$29 stock to double in the next 12 months. Of Lane, whom he has known for a year, Green says: "He's moved to the top of my radar screen."

For all the brouhaha about tainted research, there are still quite a few analysts like Lane who command the respect of investment pros. Many work

for major investment banks and brokerages, but others labor in obscurity at independent research firms that don't sell stocks or investment banking services. Instead, they shop their insights to money managers in return for commissions on trades that result from the recommendations. The ace analysts are mostly seasoned vets with Rolodexes of industry contacts. They're early risers and skeptics, detail junkies who bury themselves in balance sheets and complex stock models. In bull or bear markets, they make money for their clients, largely institutional money managers who consider their reports a must-read.

Fans among hedge-fund and mutual-fund managers, derivatives traders, and other pros say the best analysts often sense trouble before company management does. Kevin O'Brien, co-manager of the \$4 billion Neuberger Berman Genesis Fund, took a closer look at reinsurer Trenwick Group Ltd.'s books last summer after V.J. Dowling of Hartford-based Dowling & Partners Securities, known for his nitty-gritty work on insurers, warned that the company was overstating earnings. O'Brien said Trenwick executives dismissed Dowling's assessment—but he cashed out at about \$26 a share anyway. The company has since posted losses, and the stock dived to a low of 46 cents on Nov. 14. "Dowling doesn't care what anybody thinks," says O'Brien. "And he'll put it in writing."

The bear market has helped to raise the best analysts' profile. Unlike most on Wall Street, they have few qualms about bashing popular companies. For example, Fox-Pitt, Kelton Inc. finance



analyst E. Reilly Tierney downgraded J.P. Morgan Chase & Co. in May, 2001 at \$50 and remained bearish. The stock now trades at \$24. "We could care less whether stocks go up or down," he says. "Our clients make money either way."

A willingness to stand up to management is a common denominator of the elite group. Michelle R. Clayman, CEO of New York's New Amsterdam Partners LLC, a pension fund manager, singled out Morgan Stanley automotive analyst Stephen J. Girsky as one of the best. Last year, Girsky zeroed in on the way Ford Motor Credit Co. booked car loans that it packaged and sold to other investors using so-called gain-on-sale accounting. The company was getting a third of its profits from such sales, says Girsky, who believed the strategy was unsustainable—because it booked most of the income from loans up front instead of over their life. "It was a d

One analyst says he got anonymous threats—presumably t

The A Team

KEVIN P. LANE

Chief market strategist, Technimonials Research Group
Commended selling both Enron and IBM before their
stocks tanked. Rated PacificCare a buy before its
earnings surprise and 40% runup in November.

STEPHEN J. GIRSKY ▶

Automotive analyst, Morgan Stanley
Predicted disaster at Ford Motor
despite upbeat forecasts from
company execs months before it report-
ed \$297 million of losses in Q4 2001.



JOHN J. DOWLING, JR.

Finance analyst, Dowling & Partners Securities
Selling recommendation on Trenwick Group, down 87%
this year, and a buy on W.R. Berkley, up 10%.



◀ CAROL LEVENSON

Director of corporate bond research,
Gimme Credit Publications
Issued warnings on WorldCom,
Lucent, Dynegy, Consec, and J.P.
Morgan Chase months before their
stocks' steep declines.

ARAM H. RUBINSON

Retail analyst, Banc of America Securities LLC
Downgraded Home Depot in Feb., 2002, at \$50, three
months before it slid to a \$23 low. It now trades at \$26.

PAUL SAGAWA ▶

Telecom-equipment analyst, Sanford C. Bernstein
Downgraded Cisco and Nortel in September,
2000, when he predicted an impending crash
in telecom equipment. Eight months ago
reversed his bearish stance.



◀ E. REILLY TIERNEY

Analyst, Specialty finance
and brokers, Fox-Pitt, Kelton
One of the first to downgrade J.P.
Morgan Chase in May, 2001, at \$50.
The stock now trades at \$24.70.

STEVE WORTMAN

Aerospace and defense analyst, Sidoti & Co.
Made bullish calls in 2002 on Engineered Support Systems
and Signal Tech, up 52% and 64%, respectively. Now neu-
tral on both, but bullish on Herley Industries, down 10%.

Data: BusinessWeek

tion of the true results," he says. He
ed his concerns with Ford execu-
s at a private dinner in Dearborn,
n., then sent them a summary, which
published in an October, 2001, re-
e. The company continued to refute
findings, he says. Two months later,
d Credit announced a \$297 million
for the fourth quarter, the first
rtly loss in 42 years. This year,
d Motor Co.'s stock has tanked 37%.
elling it like it is is usually a thank-
job. After Sanford C. Bernstein &
analyst Paul Sagawa downgraded
eo Systems Inc. in late 2000, antici-
ng the end of the telecom boom,
eo Chief Executive John T. Cham-
s called to "respectfully disagree"
n the forecast. Soon after, Cisco's
ings slumped. "Chambers told in-
ors that no one could have predict-
it; it was a 100-year flood," says
awa. "I was, like, 'Guys, I had this

conversation with you five months ago,
and you told me I was out to lunch.'"

Sometimes, telling people what they
don't want to hear can get downright
nasty. Daniel T. Niles, Lehman Brothers
Inc.'s semiconductor and hardware ana-
lyst, says he received anonymous
threats—presumably from angry in-
vestors—after downgrading cult tech
stocks in the late 1990s. "It didn't mat-
ter that I was right," he says. Likewise,
Bernstein's phone lines were jammed
after Sagawa panned Cisco in 2000. "In-
vestors were saying that I crashed their
favorite stocks, and that I was incom-
petent, only not using language that
nice," he says. "I took a lot of abuse."

In hindsight, the most radical calls
look like common sense—backed by
hours of homework. Sagawa downgrad-
ed Nortel Networks Ltd. and Cisco in
September, 2000, after analyzing trends
for big telecom service providers, their

main customers. He ran some 40 dif-
ferent ratios on a handful of companies
and found that telecom capital spending
had reached 36% of sales, while cash
flows from operations were less than
20% of sales. Add a heap of debt, and
clearly service providers couldn't keep
buying. "It was entirely predictable, to
be honest," Sagawa says. Improving
cash flow and a slow recovery in capital
spending prompted him to turn bullish
in April on Nortel, Nokia, and Lucent
Technologies, before the Street and the
stocks' rally in October.

But common sense rarely rules mar-
kets—as money managers ruefully ad-
mit. When Gimme Credit, a fixed-income
research shop, issued a warning on
Qwest Communications International
last November, Greg Hosbein, a princi-
pal at Segall Bryant & Hamill Invest-
ment Counsel, a Chicago money man-
ager, sat tight. "The bonds were in high

investors—after downgrading tech stocks in the late '90s

demand," says Hosbein, who held \$10 million in Qwest bonds at the time. After a second warning in April from Carol Levenson, Gimme Credit's director of corporate bond research, he sold. The bonds, which traded around par a year ago, now trade at 60¢ on the dollar. "You do your own research, but then look at Levenson's reports and say, 'I must have been asleep during that part of the [company] conference call,'" he says. Gimme Credit's plain-talking daily missives now recommend buying the bonds of SBC Communications and ConocoPhillips—which most analysts still consider too risky.

At times of uncertainty, money managers look to these pros to help them navigate. By mid-January, 2002, Tyco International Ltd. was on the ropes. The Securities & Exchange Commission was investigating the company for fraud, and the shares were in free fall. Chief Executive and Chairman L. Dennis Kozlowski was on the defensive, telling investors there was nothing wrong with Tyco's accounting. At the time, institutions owned 95% of the stock, and most of the 15 or so analysts covering the company rated it a buy or strong buy. But Technimentials' models suggested the market wasn't going to buy Kozlowski's line for long. By Jan. 18, weekly trading volume was five times the average for the previous 12 months, coupled with a sharp price drop to \$45. Lane called about 70 clients on Jan. 25 telling them to sell at \$45. "Everyone thought that we were crazy," he recalls.

Sure, Lane would rather have made the Tyco call in early January, when the stock was at \$60. Even so, the clients who listened avoided a debacle: Two weeks later the stock hit \$30, eventually sinking as low as \$7. Now, Lane says to short AutoZone Inc., which he figures could fall to \$48 from \$78 now, and the drug distributor AmerisourceBergen Corp., which could go from \$60 to \$40 in the next three to six months. "They're overloved and overowned," he says.

Most money managers hate to admit they take cues even from the best analysts. On Oct. 27, star stock-picker Tom Marsico, manager of the \$1.3 billion Marsico Growth Fund, lauded Tenet Healthcare Corp., a top holding, in *The New York Times*. The next day, UBS Warburg's Kenneth R. Weakley released a negative report. A week later, Marsico sold. A press release said "new information" had soured him on the stock.

His coyness is understandable. If you have a secret weapon, why let everyone on Wall Street in on it?

By Mara Der Hovanesian in New York

The Best of the Independents

Investars.com, an online analyst-rating service, tracks the research of 104 firms, including Wall Street brokerages and boutiques. At *BusinessWeek's* request, Investars ranked the top performers among the independent shops that mostly offer investment banking. To evaluate each firm's performance, Investars creates a hypothetical portfolio, which "buys" or "sells" whenever a stock is upgraded or

downgraded. The number of shares varies according to the strength of the recommendation—more shares for a strong buy, for example, than

for a buy. The final score is a weighted average of returns for all stocks a firm covers for which Investars has a complete history of recommendations. The best calls may involve multiple buy or sell recommendations. Calls and returns are for the 12 months through Nov. 20.



BULL'S EYE: CEO François Parenteau

FIRM/ LOCATION	STOCKS COVERED/TRACKED BY INVESTARS	BEST CALLS	AVERAGE RETURN
PARENTEAU Montreal	19/19	Verisign Palm	81.4%
AVALON RESEARCH Boca Raton, Fla.	50/109	Genesis Microchip Imclone	41.2
STANDARD & POOR'S New York	1,200/ 1,604	US Airways i2 Technologies	13.9
ANALYTIQ GROUP Irvine, Calif.	37/32	Amkor Technology Maxtor	13.2
GLOBAL CAPITAL INSTITUTE (THOMAS WHITE) Chicago	3,900/ 2,538	Cytogen H Power	10.4
RDEX RESEARCH Irvine, Calif.	25/25	Rambus Intl. Rectifier	8.0
CORINTHIAN PARTNERS* New York	10/10	General Growth Prop. Bedford Properties	7.1
CALLARD ASSET MGMT. Chicago	4,000/ 4,474	Adelphia Enterasys	3.2
FULCRUM GLOBAL PARTNERS New York	135/124	Integrated Device ESS Technology	2.9
MARKET PROFILE THEOREMS Seattle	2,517/ 2,652	Covanta Energy Level 3	1.0
BARRINGTON RESEARCH* Chicago	90/85	Univ. of Phoenix Cablevision Systems	0.3
STANDARD & POOR'S 500-STOCK INDEX			-21.5%

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REVENGE OF THE INVESTOR

When he saw the news on the Securities & Exchange Commission Web site,

Floyd Schneider couldn't help but gloat. He swiftly contacted his friend and colleague, Richard M. Cocchieri, whose reaction was more subdued: satisfaction and professional

pride. There it was, about halfway down the SEC News Digest of Sept. 30, 2002: The SEC was launching a civil enforcement action against 17 defendants, led by a Texas brokerage named Salomon Grey Financial Corp., accusing them of engaging in a pump-and-dump stock swindle.

These were the targets of *their* investigation—Schneider's and Cocchieri's. This was, as far as they were concerned, *their* enforcement action.

These two men are investigators—but they don't work for the SEC or the NASD or the FBI. Cocchieri is a dentist, Schneider a mortgage broker. They are in their early forties and live in the northwest suburbs of New York City. They don't hunt corporate wrongdoers to dig up grist for lawsuits or to snag government bounties. It's not about getting

Angry shareholders are investigating brokerage fraud, waging proxy fights, and agitating for securities reform

money. It's about getting even.

Like thousands of other investors, they became involved in the markets in the late 1990s and were disillusioned, big-time. Usually the story would have ended there, with a deflated portfolio, a pile of unopened brokerage statements, and a ve-

to stay away from stocks.

With stocks tanking, widespread economic misery, and scandals draining portfolios—\$1 billion in direct losses from the eight major corporate and accounting controversies—it's no surprise that investors are fleeing. Some \$2.4 billion poured out of equity mutual funds through Aug. 31, vs. net inflows of \$43.6 billion of new money in the same period last year. But amid all that frustration, a new dynamic is emerging.

Many investors are taking matters into their own hands. They are fighting back—and winning. It's almost as if the Peter Lynch credo that the bygone bull market has been turned on its head. In his classic 1989 book, *One Up on Wall Street*, the legendary former Fidelity Magellan manager preached the virtues of self-help. That spirit is still very much alive today, only now, instead of picking stocks, invest-

Finance



GETTING EVEN

Floyd Schneider, a mortgage broker, has an arsenal of Net tools he uses to find scamsters



SUBURBAN SLEUTH Along with Schneider, dentist Richard Cocchieri investigated broker Salomon Grey

have turned to picking on their adversaries—stock promoters, online investment letters, and brokerages that push questionable stocks. Some, like Schneider, Cocchieri, and dozens of others, are investigating potential miscreants. Others are waging proxy contests and pressing for changes in SEC regulations. And they have turned state regulators around the country into the No. 1 engine of Wall Street reform.

The void at the top of the SEC—and the months of Harvey L. Pitt's widely criticized leadership—is a key reason for all this. Wall Street's own numbers tell the tale. A massive 41% of investors say that "dishonesty" is the main issue facing the securities industry today, vs. 8% a year ago, according to a survey conducted for the November annual meeting of the Securities Industry Assn., the brokerage trade group. And only 26% have much confidence that the Sarbanes-Oxley Act—which created a new accounting board and included other confidence-building measures—will substantially reduce corporate chicanery or accounting fraud.

Amid this meltdown in public confidence, investors are finding ways of compensating for the power

vacuum in Washington. Investor-activists, by providing a kind of early warning system against small-stock fraud, offer crucial tips and research to an overburdened SEC in battling a \$10 billion-a-year investor rip-off. Reacting to the portfolio losses of the rank and file, labor unions brought 40% of shareholder resolutions during the past year's annual meetings. The AFL-CIO is pushing for rules that would give small investors even more clout.

And if Wall Street thinks New York State Attorney General Eliot Spitzer is its worst nightmare, there are 49 other potential nemeses in the wings. In Utah alone, state regulators have referred 66 securities-fraud cases for criminal prosecution so far this year, vs. 35 during all of 2001. And more states are following suit by beefing up their securities-fraud laws and staffing up on scam-busters.

Even the securities industry's most cherished sacred cow,

the arbitration system for settling disputes, is feeling the rocity of investor wrath. Though the system is widely perceived as unfriendly to investors, their claims against brokers are running 12% higher than 2001's record levels. And a move by California to reduce arbitrator conflicts of interest is unfolding as a challenge for Wall Street's longtime control of the dispute-resolution process. Even before any laws change, some arbitrators are shedding their tendency to give the benefit of the doubt to large firms—as evidenced by a near \$8 million judgment that was recently won against Merrill Lynch & Co. for allegedly failing to execute a sell order. "The pendulum is shifting in favor of the investor," says Jan Zamansky, a New York securities lawyer who has successfully taken on Merrill.

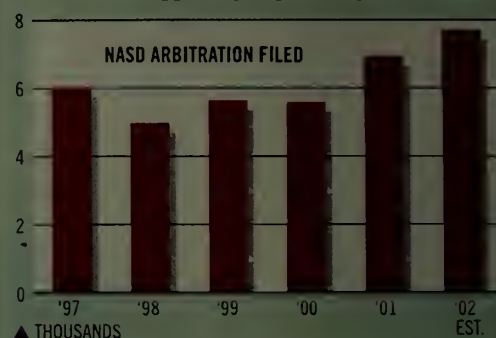
BusinessWeek has probed the depths of investor activism. The findings are surprising and, in a way, reassuring. If government continues to fall short, investors themselves will step in to do the job.

■ CITIZEN INVESTIGATORS

Cocchieri, Schneider, and people like them are the pure expression of investor self-help. When their profits turned to losses in the late 1990s, they didn't just give up. They turned to the powerful information resources of the Internet against interconnected networks of promoters who use the Net to peddle stocks. The two men—at first "dumb as a rock," Cocchieri puts it—have built a veritable armory of mostly free Net resources, including Web sites with SEC and other public documents, as well as search engines that mine other search engines. And they use them every single day.

Their research has led to a series of coups. For example, Schneider and Cocchieri honed in on a convicted stock manipulator named Theodore R. Melcher Jr., who pleaded guilty to stock-fraud charges in 1997 in one of the first federal prosecutions of Internet fraud. Melcher ran a Web site that was shut down when he was imprisoned. But after he was released in 1998, the pair found, he had gone back in business, quietly legally running an investment Web site and continuing

ARBITRATION CLAIMS ARE GROWING...



...WITH MORE INVESTORS CITING BAD INFORMATION

TYPE OF DISPUTE	YEAR		% CH
	2001	2002*	
BREACH OF FIDUCIARY DUTY	3,458	4,218	22%
FAILURE TO SUPERVISE	1,968	2,620	33%
MISREPRESENTATION	1,895	2,615	38%
UNSUITABILITY	1,524	2,591	70%
NEGLIGENCE	2,275	2,520	11%
OMISSION OF FACTS	692	1,169	69%

*NASD estimate, based on claims filed to date

Data: NASD

Finance

REVENGE OF THE INVESTOR

A black and white photograph of a man in a suit sitting at a desk, looking at a computer monitor. In the foreground, there is a snow globe containing a snowman. The text is overlaid on the right side of the image.

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LABOR'S SHAREHOLDER VICTORIES

LOBBIED the SEC intensively for the new accounting oversight board

PUSHED for a proposed SEC rule requiring mutual funds to disclose how they vote on corporate proxies.

PROMPTED more than a dozen companies to adopt reforms such as controls on auditors or limits on golden parachutes.

PERSUADED five out of 10 Enron directors to resign board seats at other companies

Data: BusinessWeek

promote small-cap stocks. Tracking the stocks that Melcher was pushing has led to other stocks and other promoters, information the two men shared with investigators.

The results of the past few months have been gratifying. Only 17 days after the Sept. 30 SEC action—which Salomon Grey, in papers filed with the SEC, has denounced as “frivolous”—the NASD brought action against a firm called National Capital Securities, which was the focus of an extensive investigation by Schneider. The NASD maintained that National Capital provided fraudulent research reports online. The NASD, citing longstanding policy, won't comment on whether information supplied by investors played a role. A person who answered the phone at National Capital's parent company said the securities firm was shutting down and that no one was available to comment.

Other investor activists are using the Internet to exchange information and put pressure on companies. The initial results have been encouraging. In late 2000, shareholders in the Texas-based Luby's Inc. cafeteria chain got organized through Yahoo! Inc. message boards. As a result, the Committee of Concerned Luby's Shareholders ran its own slate of directors and won a re-

ments, and certainly not the SEC. But today, the AFL-CIO is player. The office's director, Bill Patterson, can hardly keep pace as he pursues one reform demand after another, ranging from corporate governance to accounting standards. He's desperately hiring staff to help push new shareholder initiatives.

Corporate America has felt labor's sting most directly in the form of proxy resolutions. Last spring, unions placed 191 resolutions on company ballots, with that number comprising two-thirds of those put forth by institutional shareholders, according to the Investor Responsibility Research Center. Increasingly, companies are taking heed. For example, in October, Norfolk Southern Corp. and Bank of America adopted union-backed demands for restrictions on golden parachutes for executives. BofA now will require shareholder votes on top officers' severance payments that are more than double their annual pay. The AFL-CIO also is urging the SEC to allow stockholders who can muster support from, say, 10% of shareholders to nominate their own director candidates alongside management slates.

Already, unions are gearing up for the 2003 proxy season. They plan resolutions at every Standard & Poor's 100 company plus dozens more, bringing the total to close to 400. Patterson expects to win some of these battles before they even get to a vote. For example, this year the AFL-CIO negotiated standards on analyst independence with Goldman Sachs, Merrill Lynch, and J.P. Morgan Chase, long before Spitzer turned his gunsights on the issue.

Wall Street firms might feel beleaguered by the constant drumbeat of investor-driven demands. But guess what? It's about to get worse.

■ STATES' RIGHTS

The campaign for Indiana Secretary of State doesn't generate much attention, even in Indiana. This official issues licenses and registers corporations. Humdrum stuff. But in Indiana, the secretary of state is also in charge of securities regulation. And this year, the heat was turned up in what usually is a yawn-fest.

In this contest there wasn't a dime's worth of difference between Republican Todd Rokita, who won on Nov. 5 with 54% of the vote, and his Democratic opponent, John Fernandez. At least, not when it came to the newest mom-and-apple pie issue—securities regulation. Both men vigorously hacked

Finance

REVENGE OF THE INVESTOR

spectable 24% of the vote. The dissidents say they deserve at least part of the credit for the departure of then-CEO Barry J.C. Parker, who they had slammed for failing to boost flagging sales. The committee went on to petition the SEC to make it easier for shareholders to run their own slates of directors. The rule change is pending.

There are limits to this kind of activism. Les Greenberg, a semiretired California lawyer who heads the Luby's committee, notes that staging a full-fledged proxy contest is something few small investors can pull off. It's complex, expensive, and requires professional assistance. Fortunately, help is at hand—from a traditional foe of the investor class.

■ LABOR'S CAPITALISTS

For years, AFL-CIO's Office of Investment labored in obscurity. It opened in 1997, to act as a shareholder advocate for labor unions' billions in pension fund holdings. No one paid much attention—not union members, not company manage-



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away at a theme that had great voter appeal in this solidly Republican state in 2002: The urgent need to incarcerate corporate wrongdoers.

What is getting Hoosiers up in arms nowadays can be summed up in three letters—A-E-S. AES Corp. acquired Indianapolis Power & Light Co. in July, 2000, only to see its share price collapse when wholesale electricity prices tumbled in the

wake of Enron Corp.'s implosion. Investors were hit hard. "We have people in our own backyard now

Finance

REVENGE OF THE INVESTOR

who have lost millions of dollars," says Fernandez. "The voters feel pain, and in typical political fashion, we're responding," says Rokita.

The measure that both Indiana candidates advocated—stepped-up criminal prosecutions—is not just empty political talk. Christine A. Bruenn, Maine's securities commissioner and president of the North American Securities Administrators Assn., says: "We preach it at every conference—that the way to get the message across is to bring a criminal action."

Regulators nationwide are saying "amen." In June, West Virginia adopted legislation making it easier to prosecute brokerage firms by strengthening the laws against securities sales practice and compliance violations. In Utah, the Attorney General's office has a financial crimes unit that prosecutes cases brought by the state's aggressive securities regulator, S. Anthony Taggart. In other states, despite widespread pressures on their budgets, securities regulators are quietly ratcheting up their forces—hiring a forensic accountant here, a prosecutor there.

So while Spitzer gets the headlines, his counterparts in the hinterlands are exercising their own muscle more and more. Missouri Secretary of State Matt Blunt, for example, has vocally objected to Merrill Lynch's proposed \$100 million settlement with the states over charges that its analysts misled investors. Blunt is worried that fines are just "an operating cost for these companies: They pay the fine, which becomes just a cost of doing business." And he has a point. It's an article of faith in the securities industry that brokerage firms don't give a hoot about fines, unless they are huge. The real potential exposure comes from investors who feel they have been ripped off and would love to sue—but can't.

■ SLAUGHTERING A SACRED COW?

Through bull market and bear, one feature of Wall Street has remained the same—the arbitration system that handles disputes between brokers and customers. Administered by the NASD and New York Stock Exchange, it has long been criticized as biased against customers. Plaintiff lawyers contend that large firms have particularly benefited, because of

a widespread assumption by arbitrators that they adhere to a higher standard of ethics than smaller, less well-known brokerages.

That's beginning to change. State regulators, led by California, are pushing to make arbitration fairer. And arbitrators and juries are delivering megaverdicts against big firms. August, a couple in Pennsylvania won a \$7.7 million judgment against Merrill Lynch, which allegedly failed to execute a sell order. Merrill Lynch is appealing. In October, an Ohio judge awarded \$12 million in compensatory damages and \$250 million in punitive damages against Prudential Securities Inc. in a class action, more than 250 investors claimed that a broker had sold investments in 1998 without authorization. Prudential is fighting the verdict. The biggest judgment of all, in November, 2001, was a \$430 million arbitration award against

former UBS PaineWebber adviser Lehman Brothers Inc. broker Enrique E. Perusquia, who had pleaded guilty to stealing from customers. The Houston securities lawyer who won that verdict, Thomas R. Ajamie, believes arbitration forums remain a hazardous place for investors. Even so, some plaintiff lawyers say they believe that the big brokerages are losing their advantage. "I think it's clear that the presumptions and the biases of the panels have dramatically shifted in one specific area—which is the good faith that major brokerage firms had, going into Day One of the arbitration," says Bill Singer, a New York securities lawyer.

Even if the arbitrators themselves resist the change, the system itself is under attack from the investor's new ally, the state. California fired the first shot in September, 2001, when it passed legislation requiring new ethical standards. It requires arbitrators to disclose their potential conflicts of interest, such as business relationships between the parties and arbitrators' family members.

The NASD and NYSE were through the roof. As soon as the rules took effect on July 1, the two filed suit against California's

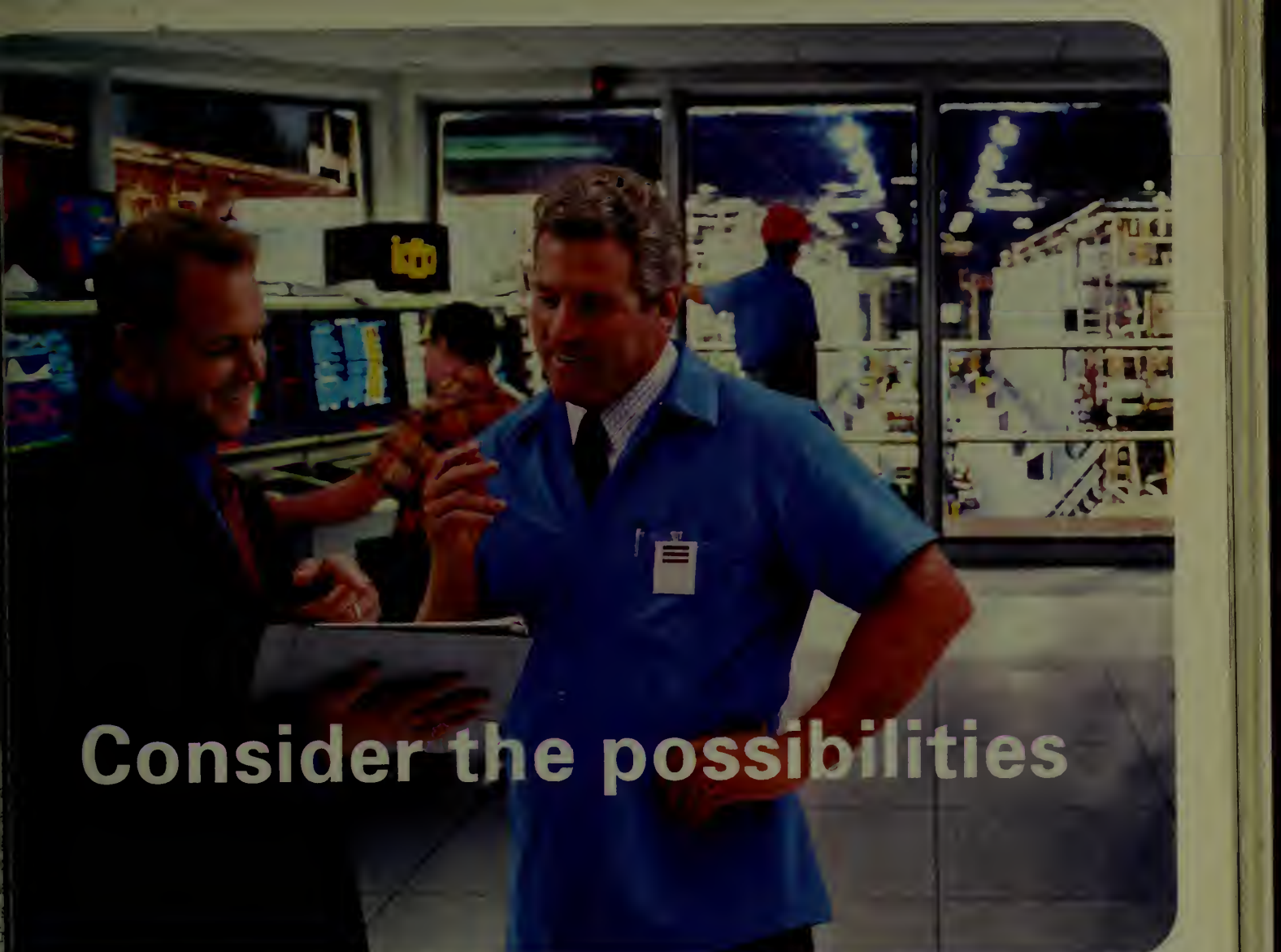
Judicial Council, claiming that the rules are excessively burdensome and are preempted by federal law. After a brief flurry of papers—with the SEC siding with the two exchanges—U.S. District Court Judge Samuel Conti on Nov. 14 dismissed the suit on the grounds that the 11th Amendment prohibits naming state agencies as defendants. The NASD and NYSE are mulling an appeal.

The struggle in California over arbitration rules illustrates the problems facing investors as they flex their muscles. Wall Street remains as eager as ever to protect its prerogatives. But in state after state their clout is being felt, whether through suburban investor-investigators or Washington lobbyists, arbitrators or local prosecutors. They're fighting to make investor voices heard, and for the first time in memory people in power are listening.

By Gary Weiss, with Aaron Bernstein in Washington, Michael Arndt in Chicago, and Emily Thornton, Mara Hovanesian, and Heather Timmons in New York



HOLDOUT Missouri Secretary of State Blunt objects to Merrill's proposed \$100 million settlement, saying it's just "an operating cost" to the company



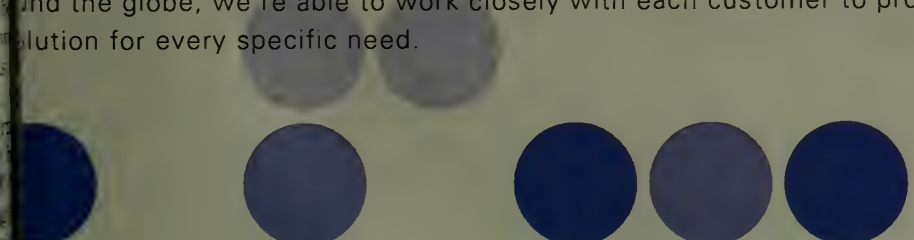
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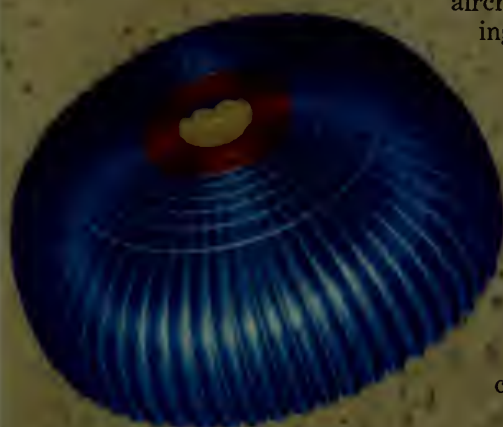
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ITE WAVES OF INNOVATION, from TV to the Internet, people still read newspapers. So instead of trying to revolutionize reading habits, PEPC worldwide, a Dutch startup, is using kiosk technology to give readers whichever newspaper they want, wherever they happen to be.

PEPC's Presspoints digital kiosks, which have already popped up in about 100 airports, business centers, and hotel lobbies around the world, can deliver the latest editions of more than 100 hometown newspapers. For just \$5, customers can select a paper and, two minutes later, lift out a black-and-white edition complete with photos and ads. Newspapers from the *Los Angeles Times* to Reykjavik's *Morgunbladid* may sign up to participate in the service. They then transmit their latest editions as

PDF files to the Systems PDF files to, which sends them by satellite to disk drives in each kiosk. PEPC has invested \$8 million to develop the kiosks, which it sells for \$10,000 a unit. *Christina W. Passariello*

A TAXI YOU HAIL AND BAIL



PEOPLE unaccustomed to small planes may be a bit leery of hailing a six-seat air taxi, no matter how advanced its engines and electronics. But planes from Albuquerque's Eclipse Aviation may boast a safety feature no jetliner can match: a parachute big enough to float the plane gently down to the ground.

In mid-November, Ballistic Recovery Systems (BRS) won a \$600,000 award from NASA to develop a parachute for jet taxis. It will be a beefed-up version of the chute the South St. Paul (Minn.) outfit already supplies to Cirrus Design for its four-seater prop planes. Nearly 400 Cirrus

aircraft are now flying, and its Duluth (Minn.) plant cranks out two more every day.

The Federal Aviation Administration has also approved BRS chutes for retrofitting on certain Cessnas.

Do the giant chutes work? Just ask Lionel Morrison, a Dallas architect. On Oct. 3, shortly after take-off in his Cirrus SR22, a piece of the left wing came loose, making the plane hard to control. So Morrison pulled the handle that launches a small rocket and deploys



the chute. He floated down from 1,500 feet—the first person to land an FAA-certified plane under a parachute. *Otis Port*

INNOVATIONS

■ If you thought rising levels of atmospheric carbon dioxide might benefit farms and forests, think again. A three-year study by Stanford University shows that if current trends in climate change are projected forward, plant growth may not drastically speed up—despite an abundance of CO₂. In the study, described in the Dec. 6 issue of *Science*, researchers exposed 32 plots of grassland to simulated climate conditions with varying levels of water, soil-based nitrogen, CO₂, and heat. Contrary to expectations, high levels of CO₂ stimulated plant growth only when the other three factors were kept at current levels. Under conditions that included higher temperatures and nitrogen levels—both associated with industrial trends behind global warming—a superabundance of CO₂ slowed the expected acceleration of plant growth.

■ Front-projection TVs can provide high-definition pictures on very large flat screens. They avoid the need for a rear-projection system's bulky cabinet, but the projector must be placed directly opposite the screen, which often means rearranging furniture. Now, Silicon Optix in San Jose has developed a chip that corrects for images projected from the side. It will show up next year in a home movie projector from Taiwan's Nexgen Mediatech.

ALL SCREAM FOR THERMOACOUSTICS

MENTS CAN OFTEN GET loud—literally—in part because shouting voices pump amounts of energy into the air. Each sound wave slightly compresses the air, which raises its temperature. In loudspeakers are used laserlike acoustic devices to amplify the compression and quickly extract the sound can be harnessed

to serve as a heat pump, for such jobs as refrigeration. In the mid-1990s, NASA exploited this principle to build a "thermoacoustic" refrigerator for use in space. But the cooling system just wasn't efficient enough to compete for down-to-earth applications.

Researchers at Pennsylvania State University have continued to hone the technology. At a December meeting of physicists, Matthew E. Poese and Steven L. Garrett unveiled the guts of an ice-

cream display freezer powered by sound. Funded in part by South Burlington (Vt.) ice-cream powerhouse Ben & Jerry's Homemade, the prototype thermoacoustic cooling system caps two decades of work begun at Los Alamos National Laboratory sponsored mainly by the Office of Naval Research.

Existing fridges, freezers, and air conditioners use chemical refrigerants that deplete the earth's ozone layer. Production of these chemicals

was banned in 1996. But their replacements are hardly cause for celebration: The new refrigerants are far worse than carbon dioxide in terms of global warming.

If further development of thermoacoustic chilling pays off as expected, it could create truly "green" refrigeration systems. Ultimately, Garrett believes, a thermoacoustic heat pump could even be hooked up to help power a new generation of hybrid electric cars. *Otis Port*



FEDEX: GAINING ON THE GROUND

Dismissed as an also-ran to UPS not long ago, it has roared back by building a bang-up ground network

Two years ago, FedEx founder Frederick W. Smith watched in frustration as his company's vaunted air express service took a beating. Rival United Parcel Service Inc., fresh off the biggest public stock offering in U.S. history, was spending lavishly on new Airbus delivery planes, building out a network of computers and wireless devices, and extending its trademark precision to the airborne delivery business. Meanwhile, more FedEx customers were bypassing costly shipments altogether and moving documents with e-mail. To Wall Street, it looked as if FedEx was doomed to years of shrinking margins and lost business. Some analysts even went so far as to suggest that FedEx would disappear in a takeover.

No one is doubting FedEx' survival today. The king of overnight shipments is enjoying a resurgence, thanks to the surprising growth of a ground-

delivery service that Smith cobbled together from acquisitions and independent truckers. Finally able to offer an alternative to costly air delivery, FedEx has added a growing number of big consumer-goods companies, such as Williams-Sonoma and Tupperware. Last summer alone, the Memphis company picked up an estimated 140,000 to 150,000 new daily deliveries because of a threatened strike by UPS drivers.

This surprising turnaround elicits grudging respect from UPS—but so far, little return fire. "FedEx has done a lot with its ground operation," says Kurt Kuehn, UPS's director of investor relations. "It has become a real good

competitor." But **SULLIVAN'S MONEY MAKER: The FedEx market share, Ground unit boasts 12% margins** not to launch a

price war. To the contrary, it announced in November that it would hike prices up to 3.9% in 2003, a move that FedEx and other shippers quickly matched. "UPS doesn't like losing market share, but we're not going crazy to get back," says Kuehn.

UPS still controls 80% of all U.S. ground shipments, compared with 10% for FedEx. But the FedEx Ground unit is growing far faster. FedEx' domestic average daily volume of packages rose 11.8% in the three months ended August 31, while UPS's fell 2.1%. Even more important is the contribution to the bottom line. FedEx Ground generates 12% operating margins, nearly quadruple those of the company's air express unit. That's a big reason why the parent company's net income in the quarter ended in August rose 45%, to \$1.1 billion, on 8% higher sales. For fiscal 2003, ending May 31, FedEx is projected

FedEx, Before and After

	2001	2003 (Est.)
REVENUES	\$19.6 bil.	\$22.2 bil.
PROFITS	\$1 mil.	\$811 mil.
CASH FLOW	-\$69 mil.	\$470 mil.
AVG. DAILY PACKAGE VOLUME	4.7 mil.	5.6 mil.
SHARE OF OPERATING PROFITS FROM GROUND SHIPMENTS	14.7%	31%

Fiscal years ending May 31

Data: Company reports, Lazard Frères LLC



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The Corporation

earn \$811 million—up 14% from last fiscal year—on 7% higher revenues of \$22.2 billion, according to Lazard Frères LLC.

By the middle of next year, FedEx should be generating 31% of its total operating earnings from ground shipments, says James L. Winchester, a transportation analyst at Lazard—up from just under half that in 2001. And offering customers a less costly alternative to air delivery smooths out the historic boom-and-bust nature of its business. “FedEx is a different animal today,” Winchester says. “It’s no longer a cyclical company, whipsawed in every downspin of the economy.”

While most of the ground service so far has been business-to-business, FedEx is now aggressively pushing into an area long dominated by UPS—home delivery.

From a small base—FedEx does not break out the number of home deliveries it makes—the fledgling service is expected to grow 140% this year. No wonder FedEx stock has risen about 15% in the past 12 months, to about \$52 per share, slightly better than the gain for UPS.

FedEx had no choice but to go with ground delivery after seeing customers flee to UPS’s lower-priced networks of trucks. But when it first launched the service five years ago, few observers expected it to catch on so quickly. The key decision for FedEx was to resist building a system from scratch, which could easily have cost it \$3 billion right off the bat. Instead, it spent \$1.2 billion to build a system by purchasing several regional trucking companies and hiring independent, and therefore nonunion, truckers operating nationwide out of 27 hubs. Those drivers deliver packages under long-term contracts in vehicles sporting the FedEx logo. “It’s a system unique to the trucking business,” says Dan Sullivan, chief executive of FedEx Ground. With demand burgeoning, FedEx plans to spend \$1.8 billion more over the next six years to add more truckers.

FedEx Ground’s strategy is markedly different from that of UPS. While UPS relies on a brown army of tight-knit unionized drivers, FedEx’ truckers are essentially entrepreneurs, motivat-

ed by a pay system that rewards them for timeliness and how much they deliver. At the hubs, FedEx uses digitized technology to track every package from pickup to dropoff. Packages that enter one of FedEx’ hubs never touch human hands. The bar codes are automatically scanned, posting the package’s place in the delivery cycle only as they move along conveyor belts, without other trucks or storage. That highly automated process enables FedEx to charge \$5 to deliver a five-pound package on the ground, compared with \$15 for air express service—prices similar to those charged by its archrival, UPS. With its legendary attention to detail and popular drivers, still holds a slight edge in terms of customer service, according to a survey by J.D. Powers. But FedEx is catching up.

Customers got a good look at the FedEx ground system when many of them turned to it out of fear of strikes by UPS drivers in support workers earlier this year. FedEx threats quickly passed, but many customers liked what they got from FedEx and stayed on. “The threat of a port strike was

godsend for FedEx,” says Brian Claiborne, principal of industry consultant Meridian Global Inc. “It made people rethink intercontinental air freight as a backup to ships.”

FedEx now has the right mix of services going forward. The company is shifting more packages to ground delivery, positioning air express as a premium service for customers willing to pay top dollar. That has enabled it to continue making money in the air, especially in its international unit, where it still dominates, says T. Michael Glavin, FedEx’ CEO of corporate services. Though international growth slowed from 2002 to 3%, those overseas markets remain highly profitable. FedEx takes \$44.70 in revenue per package on international air routes—twice what it gets in the U.S.

No one expects FedEx to eclipse UPS as the world’s dominant shipping company anytime soon. But thanks to its new strategy, FedEx is sailing more smoothly through this downturn. For investors, this is one turnaround that was delivered in the nick of time.

By Charles Haddad in Atlanta



With ground service,
FedEx now offers a
cheaper alternative to
air delivery



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INSTRUMENTS FOR PROFESSIONALS™

COMMENTARY

By Alexandra Starr

WELCOME TO THE REPUBLIC OF CALIFORNIA

Like baseball fanatics in July, Californians never tire of reciting statistics. Their sprawling state, with its mega size and macro importance, is home to one in eight Americans. California commands 54 elec-

toral votes, or 20% of what an aspiring pol needs to be elected President. And if the Golden State were an independent country, it would be the world's fifth-largest economy.

But let's just inhale some freeway

fumes and giddily speculate about what kind of country California might be if it were to strike out on its own. Its policies would certainly differ from the motherland's. That's partly due to the state's tradition of social tolerance and partly due to the continental drift that is pushing a Republican-controlled Washington in an ever-more-conservative direction. While the GOP swept control of Congress in November, allowing President George W. Bush to hold sway at both ends of Pennsylvania Avenue, California's statewide races offered a mirror image: Every state of fice is now in Democratic hands for the first time since 1882, an outgrowth of largely minority-driven gains in Democratic registration.

California keeps enacting laws that make it a progressive paradise. On issues ranging from corporate governance to global warming, the state regularly sends business lobbyists scurrying for cover and winds up with pro-consumer and pro-worker statutes that are among the strongest in the nation.

The contrast between conservatives and California mandarins is never starker than on the environment. Last year, the Bush Administration walked away from the Kyoto Treaty on global warming, citing worries about the burden on industrialized nations' economies. That didn't go down well in enviro-conscious California. In July, the state legislature imposed its own limits on greenhouse-gas emissions from autos, beginning with 2009 models. Because Californians account for 10% of the U.S. car market and other states are making noises about adopting similar standards, that initiative could have national implications.

In an effort to curb the rush to more stringent state regs, the Bush Administration is backing the auto makers' legal challenge of the new rules.

The powerful gun lobby, triumphant in the nation's capital and



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The Power to Know



many state legislatures, mostly fires blanks in the Republic of California. Gun-control advocates were delighted in August when the state opted to strip gun manufacturers of their immunity from product-liability lawsuits. The Republican congressional leadership, meanwhile, sought to preempt the state law with a federal statute.

"While we're playing defense with the federal government, California gives us hope," says Matt Nossanchuk, litigation director of the Violence Policy Center, a gun-control group.

While California and Washington obviously do not see eye-to-eye too often, government officials on both coasts collided outright over energy policy in 2001. As the state's electricity prices went through the roof, Democratic politicians, led by California Governor Gray Davis, pressured a reluctant Administration to impose federal price caps. Washington ultimately relented, but California is still taking a more aggressive stance than the feds in seeking restitution for alleged price-gouging by energy companies.

The state isn't just taking on energy producers. Earlier this year, California Treasurer Phil Angelides announced that his office would cease investing in companies that incorporate offshore to skirt paying U.S. taxes. "California has no reason to trust that Trent Lott, Dennis Hastert, or George Bush will protect shareholder interests," says Angelides. "It is our duty to take the lead." The GOP House, meanwhile, tucked a provision in the Homeland Security Act that allowed offshore corporations to bid on contracts with the new agency.

California wasn't always a liberal hotbed. This is the state that spawned the Proposition 13 tax revolt and became the breeding ground for the Reagan Revolution. But unfortunately for the dwindling cadre of Reaganites, a demographic tide

that has flooded the state with Hispanic and Asian immigrants has transformed it into one of the country's Democratic bastions. The trend, some political observers say, could soon alter the electoral map in other states, from Illinois to New Jersey. "California has always been a bellwether in national politics," says

role for government," says Mark Baldassare, senior fellow at the Public Policy Institute of California. Indeed, in November, Davis lost the white vote to his Republican challenger, hard-right millionaire businessman Bill Simon. It was the support of minorities that gave Davis his five-point margin of victory.

And there are the missteps of the California GOP. The party machinery is controlled by a strident minority of hardcore right-wingers, but the practical effect of that iron grip has been to nominate archconservatives who cannot carry swing voters statewide. For example, despite White House pressure, Republicans selected Simon over Richard Riordan, the moderate former mayor of Los Angeles, to challenge Davis. "The underlying demographics have changed," says Bruce E. Cain, director of government studies at the University of California at Berkeley, "but the GOP candidates haven't."

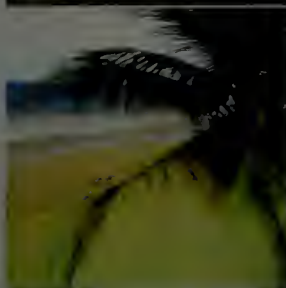
The fact that Davis won the race by a relatively small margin, however, has given some Republicans a glimmer of hope. They point out that states such as Texas and Florida are experiencing demographic trends similar to California's yet have remained in Republican hands. "There's no reason we can't do the same thing in California," says GOP political consultant Dan Schnur.

But for the next four years, at least, expect the Golden State to zig where the Bush Administration zags on issues ranging from health care to product-liability reform. And the state's size and track record for sparking trends

means it will be a force to be reckoned with. "Republicans are going to have to tolerate California," says Fernando J. Guerra, a professor of political science at Loyola Marymount University in Los Angeles. "You can't ignore the fifth-largest economy in the world."

With Ronald Grover in Los Angeles

CALIFORNIA'S DIFFERENT DRUMMER



TAX HAVENS Earlier this year, the State Treasurer's office ceased making investments in or doing business with U.S. companies that locate offshore to avoid paying taxes. The federal Homeland Security Act, by contrast, includes a provision—inserted by the House GOP—that allows companies incorporated offshore to bid on contracts with the new agency.

GLOBAL WARMING California is the first state to require auto makers to reduce greenhouse-gas emissions. The Justice Dept. has filed a brief in support of car manufacturers' legal challenge to the new rules.



GUN CONTROL California passed legislation allowing gunmakers to be sued under product-liability laws. The Republican-controlled Congress is considering legislation that would override the state law.

FAMILY LEAVE California adopted the nation's first policy providing for paid family medical leave, which will allow workers to take compensated leave for up to six weeks to care for a newborn or adopted child—or to minister to a seriously ill family member. The federal version allows only for unpaid leave.



ENERGY California's State Attorney General has sued electricity producers for allegedly overcharging consumers during the state's power crisis. The Federal Energy Regulatory Commission has been slower to act.

John Judis, co-author of *The Emerging Democratic Majority*.

Latinos now make up 17% of registered voters in California, up from 5% a decade ago. The fact that many new citizens are struggling financially and are dependent on safety-net programs also builds support for liberal pols. "They want a larger

AND TO THINK, THEY'RE MISSING
HOLLYWOOD SQUARES FOR THIS.



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MAKING LIFE RICHER

How to Land a Board Seat

Who and What You Need
To Know **Page 138**

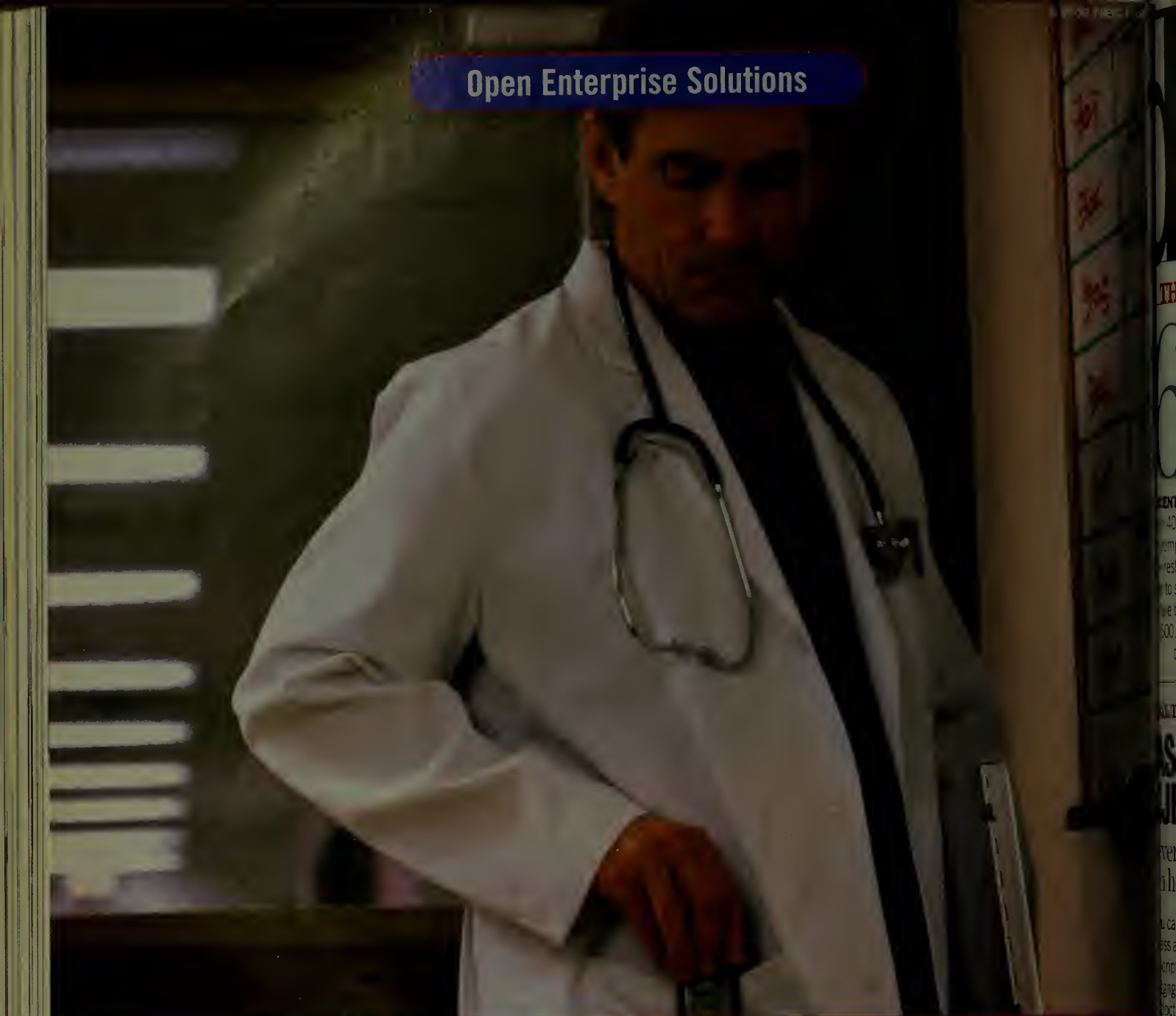


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THE STAT

68

PERCENT of companies that
with 401(k) contributions
company stock place
restrictions on the
to sell that stock. The
are based on 106 plans
600,000 participants.

Data: Vanguard Group

HEALTH CARE

SH ECTION

reverse mortgages
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can't wait for Congress
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the doctor ordered to help you
pay for medication.

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converts home equity into
cash. You receive a monthly
payout to use for drugs—or
anything else—while you live
in your home and don't make
mortgage payments.

WHO QUALIFIES?

Homeowners 62
and older.

WHAT ELSE INFO?

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mortgages for
Health Care,
the National
Reverse Mortgage
Assn.
(reverse-
mortgage.org)



KIDS' STUFF

Mind Yer Manners

HERE'S YET ANOTHER activity for our over-
scheduled kids: **etiquette classes**. Held at posh
venues such as Manhattan's Plaza Hotel and the
Four Seasons in Newport Beach, Calif., the courses
teach kids which is the salad fork and how to pass
the salt and pepper properly. Besides perfecting table
manners, these sometimes wait-listed courses advise
youngsters on how to shake hands, be courteous on the
phone, and write thank-you notes.

Who's behind the **Miss Manners** mania? Parents who want
to return to social formality but are too rushed to incorporate
good breeding into their lives. "Few families sit down to
dinner together anymore, and that's where children used to
learn these skills," says Karen Broussard-Marlow, who runs
the Manners Do Matter etiquette school in Houston.

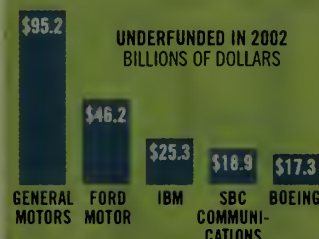
Charm schools range from the Plaza's quickie \$50 two-
hour dining sessions for kids 6 to 16 (no Game Boys or
licking knives) to 10-session \$275 courses at country clubs
that teach white-gloved girls to pour punch and boys in
suits how to cut in on a fox-trot.

Susan Scherreik

BENEFITS

POOR PENSION PLANS

Shrinking stock prices and
falling interest rates have left
many pension and retiree-
benefit plans hurting. Here are
the companies most affected:



ESTIMATES AS OF NOV. 1, 2002, BASED ON 10% DECLINE
IN ASSET VALUES AND ONE-HALF PERCENTAGE POINT
DECLINE IN BOND YIELDS
Data: Merrill Lynch

TIME OFF

FEMALE INITIATIVE

Everyone knows that
Thomas Jefferson
wrote the
Declaration of
Independence.
But did you know
that Mary
Katherine
Goddard published
the first copies? Her
story is one of 40 told in

**Enterprising Women:
250 Years of American
Business**, organized by the
Radcliffe Institute.

Appearing now at the
National Heritage Museum
in Lexington, Mass., it will
travel to New York, Atlanta,
Washington, Los Angeles,
and Detroit
(enterprisingwomenexhibit.org).



Angling for a Board Seat?

You couldn't have picked a better time. Companies are prowling for independent directors. **BY LOUIS LAVELLE**

EVERY TIME a new corporate scandal unfolds, executives come out looking sinister and corporate directors seem just plain dumb. How many times have you thought you could do a better job than any of those directors?

If you think you're up to the task, you couldn't have picked a better time to seek a board seat. With new governance rules placing a premium on independent directors, many boards are on the prowl for new members, and they aren't limiting themselves to the executive suite. True, landing a spot on General Electric's board is still a stretch for a first-time candidate. But with the right credentials, finding a seat on a less prestigious board is now well within your reach.

Headhunters who specialize in board searches say the best place to start is with ruthless self-examination. Boards still want directors who are sitting CEOs,

but many are willing to recruit a second- or even third-in-command today, figuring that the candidate will occupy the top job before long. Almost as important to a recruiting board: specific skills that fill a niche. If a board is replacing a director whose specialty is marketing, your background in chemical engineering won't help. Another big plus is diversity. All other things being equal, women and minority candidates are in high demand, especially among all-white, all-male boards.

DIRECTORS COLLEGES

If your résumé can use polishing, a director wannabe has several options. Many schools—including Stanford, Wharton, and the University of Georgia—host “directors colleges,” where board mem-

So You Want to Be A Director

Here's how to improve your shot at landing a board seat:

1 Enhance your Credentials

Wait for a big promotion or award, or serve on a charitable board before starting your search



s and aspiring directors learn the
es of finance, governance, and ethics.
ending not only demonstrates your
rest in board service, it gets you
time with directors, who may be
to offer leads on openings.

Industry associations, community ac-
ties, and charitable groups will also
e your profile. "Most people, particu-
ly in middle management, tend to
their head down and spend less
e thinking about the outside world,"
Julie Daum, who heads Spencer
rt's board-search practice. "It's your
tation in the outside world that will
you on the board."

Networking, headhunters say, is criti-
y important for any director candi-
. That's how Pamela Nicholson land-
er first board seat. After the senior
-president told her CEO at Enter-
e Rent-A-Car, Andrew Taylor, that
was interested in board service, he
mmended her for an Energizer

Holdings board seat that he
had declined, citing other
commitments. Glenda
Price, the president of
Marygrove College in
Detroit, was recom-
mended by a col-
league for a seat on
the Compuware
board that she
landed on Oct. 1.

Says Price: "I wasn't seek-
ing it and I wasn't aware I
was being considered for
it. It came out of the blue."

INSIDE TRACK

If you don't have a net-
work of business profes-
sionals who may be helpful
in your search, create one
from scratch. Jeff Christ-
ian, CEO of the Cleveland-
based search firm Christ-
ian & Timbers, advises
business professors to tap
into the rich vein of fellow
academics who frequently
sit on corporate boards,
and for mid- or senior-level
managers to volunteer to
make or assist in presen-
tations to their own com-
pany's board. Peter Crist,
the vice-chairman of
Korn/Ferry International,
recommends buttonholing
lawyers, accounting part-
ners, and investment
bankers, who frequently
have an inside track on
board openings. Says Crist:
"If you're looking to be the
product, you have to net-
work appropriately."

Perhaps the best way
to land a board seat is to
work with a headhunter.
While most search firms
are retained by boards,
not would-be directors,
they're uniquely positioned
to match your skills and
abilities with the right board. Some,
like Korn/Ferry, have programs de-
signed to locate newcomers to board
service—a group boards increasingly
are turning to as more traditional can-
didates, such as CEOs, scale back on
board commitments.

Once a potential match is made, the

HARD WORK THAT'S WORTH IT

What can you expect when you finally land the board
seat you've been eyeing? A lot of work, but also
considerable rewards.

■ **THE NATIONAL ASSOCIATION OF CORPORATE DIRECTORS SAYS A BOARD MEMBER TYPICALLY PUTS IN 150 TO 200 HOURS A YEAR**, including prep time, meetings, and travel. Most boards meet at head-
quarters about **six times annually** and convene occa-
sional conference calls, but a dozen in-person meetings
is increasingly the norm—and upwards of 50 meetings
and conference calls a year is not unheard-of.

■ **MEETINGS OFTEN TAKE PLACE OVER TWO CONSECUTIVE DAYS** and include a dinner and
several committee sessions. The audit committee,
once the province of newbie directors, is now reserved
for those with the required "**financial expertise**," so
newcomers are more likely to find themselves on the
compensation or nominating committees.

■ **MANY BOARDS ALSO HOLD MULTIDAY "RETREATS"** where members gather to discuss
strategy. Some require directors to **visit company
operations**. General Electric asks its independent
directors to visit its businesses twice a year as a group,
and Home Depot requires 20 store tours annually.

■ **WHAT DOES A DIRECTOR GET FOR ALL THAT TROUBLE?** Even at the smallest companies (under
\$200 million in revenue), **annual pay averages
\$45,309**, according to the NACD, including a goodly
amount of stock and options. At the biggest companies
(more than \$8 billion in revenue), **directors earn an
average \$151,776**—excluding consulting fees, legal
retainers, and other deals directors sometimes arrange
on the side. All in all, not bad for 200 hours of work.

process of winnowing the field of candi-
dates begins. Search firms will start
with perhaps 100 candidates for a single
vacancy. Working with the board's nom-
inating committee, the headhunter whit-
tles the number down to 20 or so, then
eventually to five—eliminating anyone
who lacks the requisite skills, fails

2 Network
Put out word
of your interest
to professionals
and directors
who may have
the inside
track on
open slots

3 Target your Search
Concentrate on
companies
where your skills
or knowledge of
a particular
industry would
be a good fit

4 Call a Headhunter
Seek out search
firms retained to
fill vacancies or
with programs to
find candidates
who have never
been a director

a background check, has business ties to the company, or isn't interested.

CHEMISTRY

Candidates who make the cut are advised to study up. You should read everything written on the company, especially the financials, and determine if the company has adequate liability coverage for directors. Next comes the interview with the

board members. Here the board is looking for qualities that don't come through on paper: questions that demonstrate your knowledge and insight, enthusiasm for the job, and chemistry. "They want people with backbone, but who are capable of working in a group," says Crist. "They're looking for raw intelligence. And you've got to be willing to work."

If chosen by the nominating commit-

tee, your name and short biography will appear in the proxy, and the election will be at the annual meeting. Since shareholders can't vote against you—they can only withhold their votes—the election is usually a forgone conclusion. Those who don't get the nod shouldn't burn any bridges. Ask the search firm what you weren't chosen. A gracious note from the CEO wouldn't hurt either.

TAXES

What to Do with A Ravaged IRA

Try changing it to a Roth. **BY CAROL MARIE CROPPER**

FINALLY, YOUR chance to do what your mother always told you: Make the best of a bad situation. With investments shrunken to Alice in Wonderland size, now could be your opportunity to convert your traditional individual retirement account to a Roth IRA. Or, if you converted to a Roth when the market was higher, you can avoid taxes rung up during that transaction.

Roths come with that rarest of benefits—tax-free appreciation. You can't deduct your annual contribution—up to \$3,000, or \$3,500 for those 50 and older—as with a traditional IRA. But unlike the traditional, you owe no taxes when you pull out the money in retirement.

While you can take your money from an old IRA and pour it into one of the newer Roths, you'll owe taxes on the amount converted, since it gets added to your income. But with portfolios ravaged, "it's like a half-off sale," says Ed Slott, publisher of *Ed Slott's IRA Advisor*. An IRA that has plunged from \$100,000 to \$60,000 will cost a lot less to convert than it would have before.

The biggest hurdle is you can't convert at all if your modified adjusted gross income tops \$100,000 (for either a single person or a married couple). Even if you're eligible, you may decide you can't afford to—especially if the jump in

income makes you lose out on other tax deductions, triggers taxes on your Social Security benefits, or pushes you into the alternative minimum tax system.

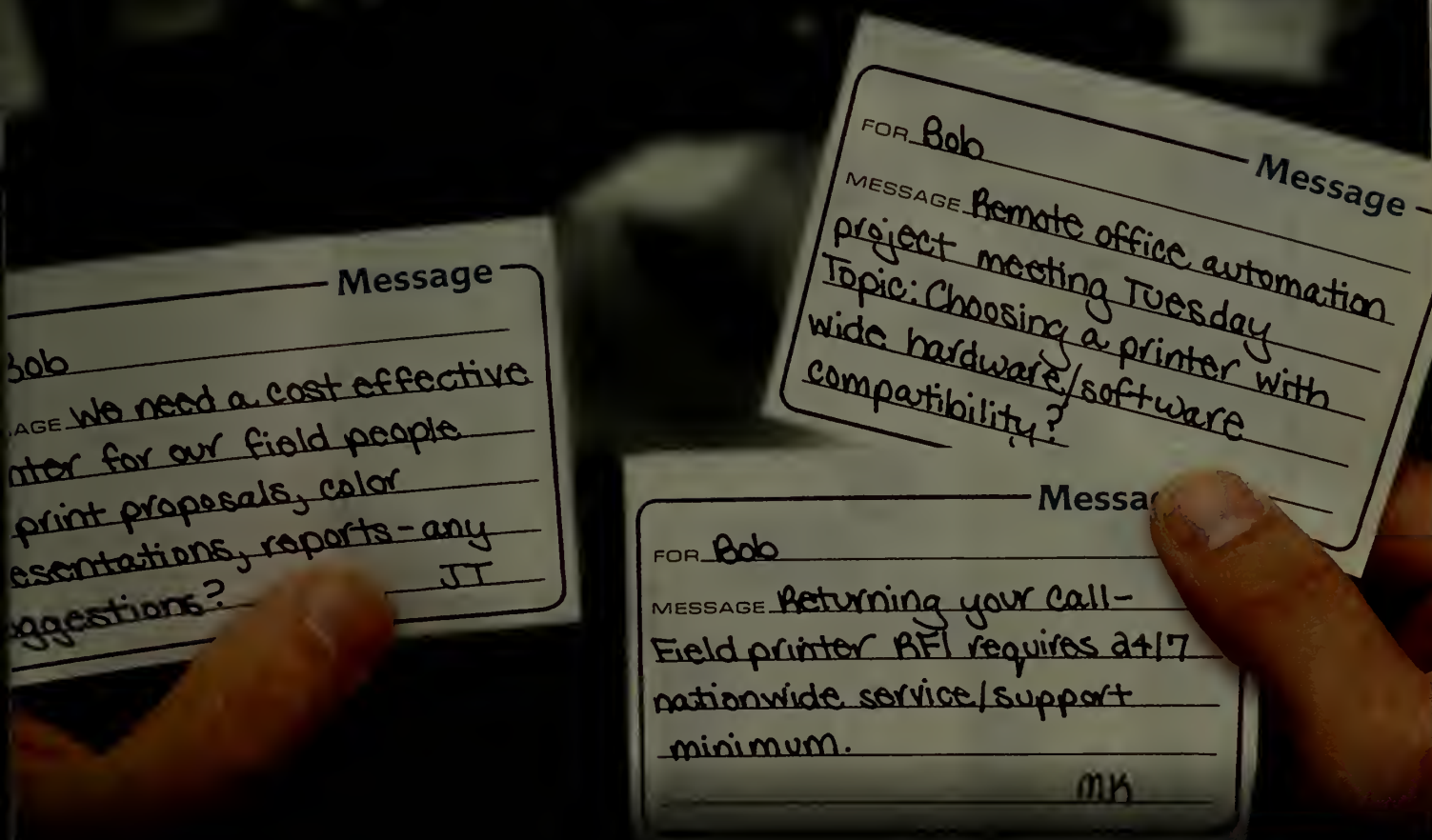
You also have to decide if a Roth is best for you. Generally, the longer until retirement, the more the Roth's tax-free vs. a traditional IRA's tax-deferred appreciation matters, says Bob Scharin, editor of RIA's *Practical Tax Strategies*, a

magazine for tax pros. Also, if you think your tax rate will remain high after you retire, a Roth becomes more alluring. Tools at vanguard.com, kiplinger.com, and businessweek.com can help.

There is a flip side to this strategy. Those who acted last year, or even earlier this year, may have converted too soon if their investments have fallen further. If you converted this year, you have until Oct. 15, 2003, to change your mind and put the money back in a traditional IRA, wiping out your tax bill.

If you converted in 2001, you could empty the Roth and claim the loss as a miscellaneous deduction. This is only worth doing if your Roth is small you won't mind losing it as a retirement vehicle, and if the loss is high enough to meet the 2% adjusted gross income threshold for claiming miscellaneous deductions. You don't want to close out your Roth and reap no benefit. Or, as your mother would say: Look before you leap.





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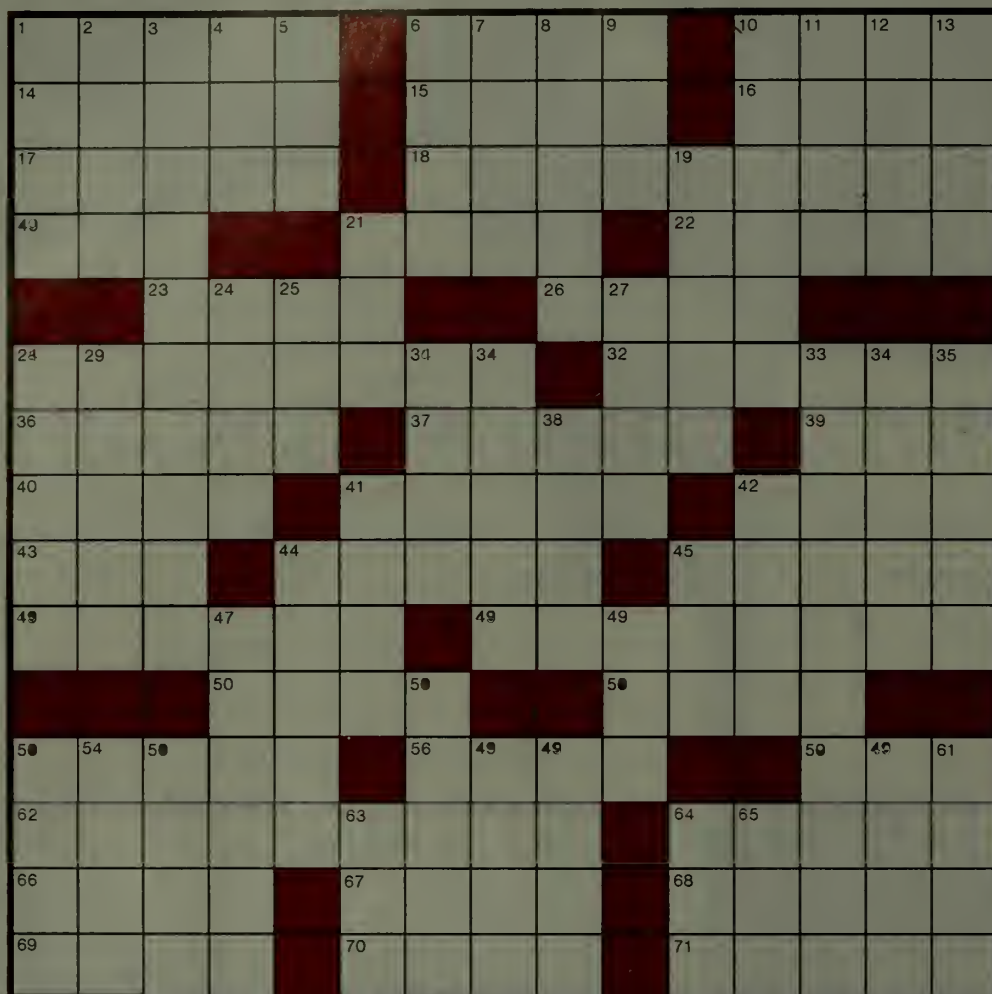
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Mixing Business with Pleasure by Lincoln



DOWN

1. Rogues
2. Software buyer
3. Transferee's move
4. Retail-purchase increment in Canada: Abbr.
5. Pilot's announcement: Abbr.
6. Intend
7. On a cruise, perhaps
8. Start of the second quarter
9. Letters on a telephone
10. Industrialist's holdings
11. Paper unit
12. Cooking spice
13. Author Haley
19. Former Clinton adversary
21. Contest of words
24. Envelope abbreviation
25. Verizon ancestor
27. First stock issues: Abbr.
28. National symbols
29. Hawaiian island
30. Ostrich relative
31. Delicious
33. Piece of stationery
34. Optimal
35. Workweek-calendar letters
38. Japanese soup flavoring
41. Feudal worker
42. Chicago slugger
44. Freezing temperatures
45. College senior's test: Abbr.
47. More than multinational
49. Flying saucer
51. Intermediate government sec
53. Amaze
54. Prepare for a photo
55. Prefix for present
57. Designer Klein
58. Tatter
60. Therefore
61. Golf-course areas
63. Top of some rating scales
64. Poorly lit
65. Printer's widths

ACROSS

1. Arthur Laffer created one
6. Polite term of address
10. Writer Bombeck
14. Take __ (rest)
15. Fox Sports Channel rival
16. Expense-account item
17. Atlanta-based airline
18. Honeywell division
20. Sign of a sellout
21. __ B'rith
22. Big name in watches
23. Brokerage back-office area
26. Dishonest one
28. "Imitation is the sincerest form of __" (see page at right)
32. Early tourney round
36. Coffee order
37. Toastmaster's asset
39. Maryland summer clock setting: Abbr.
40. Have __ with (know well)
41. "Final Four" rounds
42. One-pot dinner
43. Investigative arm of Congress: Abbr.
44. Work groups
45. Reached
46. Brother competitor
48. "Especially when it's __ you're imitating" (see page at right)
50. Resigned
52. Market motivator, at times
53. Piece of silverware
56. Hemispheric alliance
59. __ up (agitated)
62. Investment banker's ad
64. Caterpillar alternative
66. Annapolis school: Abbr.
67. Sicilian volcano
68. PR department concern
69. Astronaut Armstrong
70. __-do-well
71. Windows ancestor

For answers to this puzzle:

Turn to page 157 in this week's issue of BusinessWeek or access Mixing Business with Pleasure by Lincoln through any PDA*. Visit businessweek.com/lincoln/ and enjoy 8 puzzles over the next 2 months.

*Palm OS™ or Pocket PC™ digital assistant

Puzzle created by: Stanley Newman.



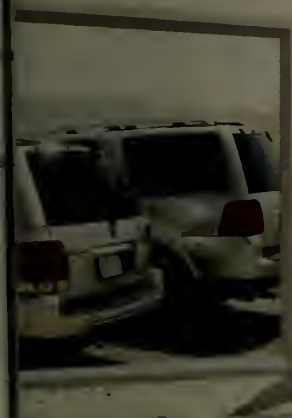
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Whittle Away Your Tax Bill

Some shrewd moves now can ease your load in April.

BY ELLEN HOFFMAN

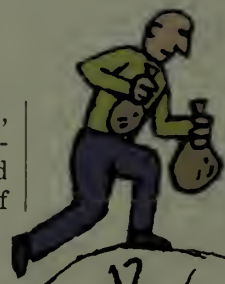
MIDNIGHT, Dec. 31, signals the end to most of your opportunities to lower your 2002 tax bill. In ad-

dition to the tried-and-true strategy of postponing income until the next year and the obvious deductions you can take before the midnight bell tolls, here are other steps that might help you this year:

- Dig into your pocket to increase your 401(k) contribution for 2002 to the new limit of \$11,000 or, if you're 50 or older, to \$12,000. If your original salary deductions don't add up to the max, immediately contact your plan administrator to ensure that you can make the extra contributions before the Dec. 31 deadline.

- Budget so you can afford to save \$12,000 in your 401(k)—or \$14,000 if you qualify for the catch-up for people 50 and older—for 2003.

- Open a spousal individual retirement account and contribute up to \$3,000 (\$3,500, for a husband or wife 50 or older) for a nonworking spouse, as long as



contributing \$2,000 per child to Coverdell Education Savings Accounts, up from the \$500-per-child limit last year. Deadline for contributions is when you file your return (not including extensions).

- See IRS Publication 970, *Tax Benefits for Higher Education* (www.irs.gov), for

new, more liberal Coverdell ESA rules if you're contributing for a special-needs student.

- Give holiday cheer to your kids, grandkids, or anyone else you love by taking advantage of the higher gift-tax exclusion of \$11,000 per person for 2002, up \$1,000 from last year.

- Encourage your young adult children to start saving for retirement now. A child who's over 18, not a full-time student, with an adjusted gross income of less than \$25,000 can take the new "Saver" tax credit of up to \$1,000 for putting money into an IRA, 401(k), and certain other retirement accounts. If the child is married, the couple may have an adjusted gross income of as high as \$50,000 and

still qualify for a credit.

- Spring for a new car. If you use it at least 50% for business, you can deduct up to \$7,660 under a new first-year depreciation deduction. For an electric car, the deduction may go as high as \$23,080.

Until the midnight bell tolls on Dec. 31, you can put any or all of these strategies into action

your modified adjusted gross income is \$160,000 or less.

- If you're self-employed, try to postpone paying health insurance premiums until 2003. The deduction increases to 100% then, from 70% in 2002.

- Fatten your kids' college accounts by

Q&A

GO EASY ON THE MUNIS



Joe Deane has been investing in the municipal bond market for more than 33 years and has an enviable record managing the \$3 billion Smith Barney Managed Municipal

Fund. Through Nov. 29 this year, it returned 6.5%. He spoke recently with Senior Writer Robert Barker:

Q: Should investors be trimming their muni-bond positions?

A: This is not a time for people to try and hit home runs in the bond market. Interest rates are the lowest we've had in 48 years, and they could back up some. That's why I think you'd rather be a little bit more conservatively positioned in the bond market.

Q: So, no bets on long-term bonds and their heavy exposure to the risk of higher rates. Which bonds, then?

A: If you're going to be buying individual bonds yourself, you should probably buy them somewhere between 3 and 10 years in maturity. You're going to go way beyond that in terms of maturities, I think you'd be far better off in a well-managed bond fund. It's just going to be much more conservatively positioned.

Q: How do investors get into trouble when they buy muni-bond funds?

A: When you get down to where we are today—in very, very low interest-rate environments—people still want yield so they have a tendency to buy funds that use a lot of leverage to give them the additional yield that's really not in the marketplace. It's one of the telltale signs that I look for as a potential sign a top in the bond market.

Q: Do you see that happening now?

A: Yes.

Q: What's a realistic expectation for investors in intermediate-term munis?

A: In terms of [annual] total return, you're looking at 4%—your coupon, and maybe a teeny bit more.



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IBM

This Wagon Can Move

Audi's Avant is powerful and nimble. **BY DAVID WELCH**

LONG ECLIPSED by minivans and sport-utility vehicles, station wagons are now making a modest comeback. Audi's A4 Avant Quattro, which sells for around \$40,000, is proof enough that wagons are a lot cooler than they used to be.

The all-wheel-drive Avant handles nearly as nimbly as BMW's 3-series mod-



els, and it's as luxurious as any European entry-luxury car. I climbed into the Avant and immediately noticed the smooth leather and polished chrome. My test car had very supportive black leather seats with six levels of heating. And there's plenty of legroom for drivers taller than 6 feet. The red LED gauges are as modern-looking as anything on the road. Another great thing about the Avant (and any Audi, for that matter): Everything on the dashboard is snapped together with near-perfect precision.

The car has a great ride, thanks to an all-new 3-liter V-6 engine that kicks out 220 horsepower. Coupled with a smooth transmission, the Avant powers ahead nicely. Like any Audi, the steering is fantastic. The car can dash between lanes like a good sports sedan. I never felt like

I was driving a bulky wagon.

The Avant seats five, and the rear cargo area can take a few golf bags with no problem. But the legroom is a little tight for passengers in the rear seats, and even the Ford Escape compact SUV has more storage space. Still, for the way many people use SUVs, this car could be a reasonable substitute. And there's a bonus: The Avant does have an SUV's rough-and-tumble ride.

It's also a lot more stylish. Audi marketing folks say the car is so much more fashionable than yesteryear's wagons that they call the Avant a sedan. It's a wagon, but only because wagons have come a long way.

A SUBSTITUTE FOR THE SUV?

Without the rough-and-tumble ride, and it handles golf clubs

BICYCLES

A Cyclist's New Best Friend

Everybody knows that powering both the front and rear wheels on a car or truck vastly improves traction. Cyclists, though, have had to make do with rear-wheel-drive. Now, Christini Technologies (christini.com) has built a **two-wheel-drive mountain bike** that works like a pedal-powered Jeep.

Christini's design runs

a pair of driveshafts, powered by a small gear on the rear wheel, through the bicycle's frame. A gear in the headset (where the handlebars meet the frame) transfers power to another driveshaft that runs down the fork and, in turn, attaches to a gear on the front wheel. The whole affair adds 2.7 pounds to the bike.

The bike's price is steep at **\$3,000 to \$4,000** (depending on the options you choose). But so

are the hills you'll be able to climb when you click the all-wheel-drive button.



David Ro

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Turn the Family into High Art

How to pick a portrait painter

BY CAROL MARIE CROPPER

EVEN IF YOU AREN'T a millionaire, you can still have a painting of your wife posed like John Singer Sargent's riveting Madame X. Or maybe the family arranged like royalty à la Velázquez.

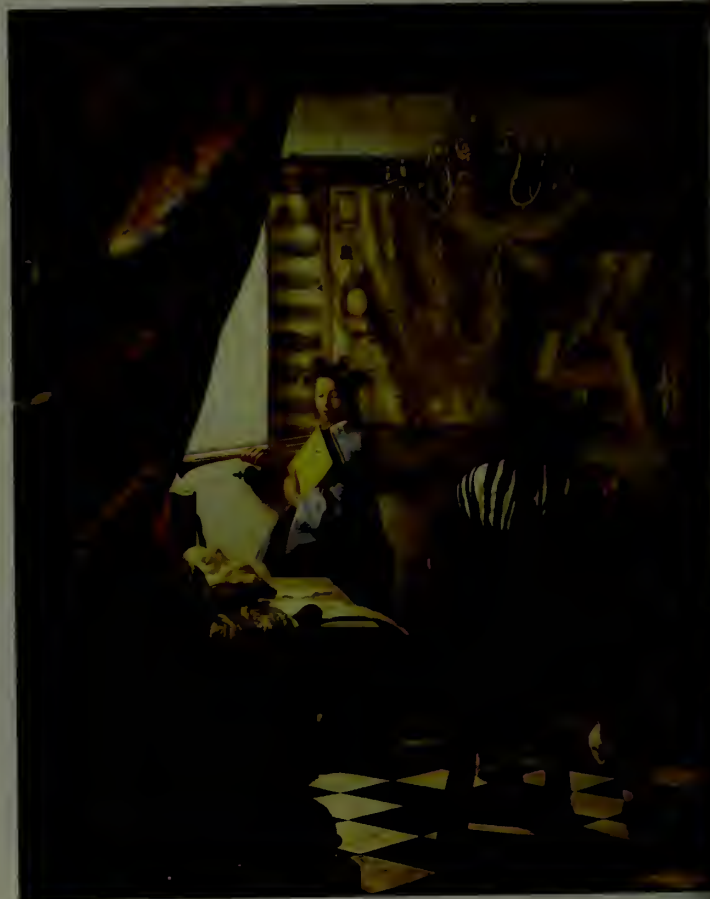
Modern artists charge as little as \$3,000 for a head and shoulders painting, although \$5,000 to \$12,000 is more the norm. A family portrait might cost a mere \$15,000 (\$35,000 is more typical). Of course, a big-name portrait artist such as Nelson Shanks, who painted Princess Diana, or Aaron Shikler, portraitist for First Ladies Jacqueline Kennedy Onassis and Nancy Reagan, could run into six figures—if you can even make their waiting list.

First, decide how much you want to spend. Then, you can ask friends, visit an agent's gallery, or even turn to the Internet to find an artist. Many have their own Web sites, and other sites provide information about dozens of painters. A Stroke of Genius (portraitartist.com) features the work of 150 painters, and the American Society of Portrait Artists' site (asopa.com) lists artists by state, noting awards. It also has links to agents and galleries representing portrait artists.

A MATTER OF STYLE

Using an agent might eliminate the bargain artists, but it will let you compare dozens of portfolios and original paintings in one stop. Manhattan's Portraits Inc. represents 150 artists. The Portrait Group, in Reston, Va., has 50.

Once you find artists who fit your budget and schedule, compare styles. Some paint with such detail that the finished product resembles a photograph. Others use more fluid, impressionistic strokes. Some slather on paint à la Van Gogh.



CAPTURING BEAUTY: Johannes Vermeer's "The Artist in His Studio"

Make sure the artist has experience with the type of portrait you want. Some artists are better known for painting corporate chieftains—New York artist John Howard Sanden, for example, has painted Laurence Tisch and Sanford Weill. Others have a large portfolio of society women (like Manhattan's James Childs) or families (Jonathan Linton, of Chatham N.J.). While most portraitists will adjust their work to please the client, a few insist on painting warts and all. Find out which type you're dealing with before you pay a deposit, which could run half the final price. It might not be refundable if you don't like the result.

Finally, ask how the artist works. Some rely heavily on photographs. Others demand repeated sittings, lasting hours at a time. Of course, you expect the painting to look like the subject, but a fine artist will go beyond that, engaging the viewer with a personality that comes alive in the room. That's what made Velázquez and Sargent famous. Even if your likeness never hangs in the Louvre, becoming a piece of art could be a refining experience.

Sweet Tooth

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TOM'S MOM'S COOKIES

(231) 526-6606
tomsmomscokies.com
Minimum order:
Two dozen for \$32
Dense, soft cookies with enormous chunks of chocolate, walnuts, dried cherries, coconut, or macadamia nuts.

WICKED GOOD COOKIES

(800) 2WICKED; www.wickedgoodcookies.com
Minimum order: 18 cookies for \$19.
Home-baked taste. Traditional varieties like chocolate chip, peanut butter, and seasonal sugar cookies.

LEVAIN BAKERY

(877) 4LEVAIN
levainbakery.com
Minimum order: Four 6-oz. cookies for \$30.
Rich taste and texture despite lumpy appearance. Try the chocolate, peanut-butter chip.

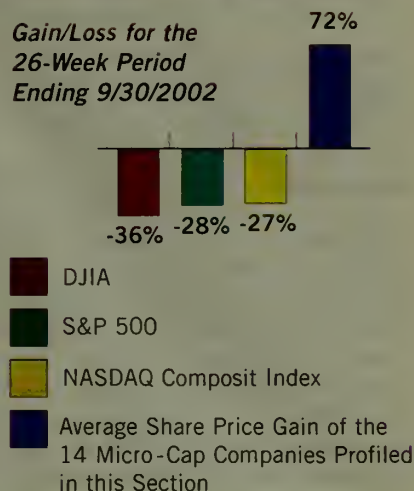
Kate Murphy

THE EQUITY INVESTOR'S 26-WEEK MICRO-CAP REVIEW

SELECTED PROFILES OF THE NATION'S TOP PRICE-PERFORMING MICRO-CAP COMPANIES AS OF 9/30/02

From the approximate 3,700 domestic companies with market capitalizations under 200 million dollars, the following pages highlight selected firms in the top 10%, in terms of share price performance for the 26-week period ending 9/30/02. Each profile describes a leading company including its industry, market trends and reasons for success, as written by company management. And while past performance is never a guarantee of future results, these top-performing companies represent investment opportunities worthy of a micro-cap investor's close consideration.

Gain/Loss for the
26-Week Period
Ending 9/30/2002



YoCream International • YOCM • Food Processing

Portland, OR • IR Contact: Terry Lusetti • 800-YOCREAM ext. 206
www.yocream.com • terry@yocream.com



YoCream International produces and sells frozen yogurt, frozen custard, ice cream and smoothies to the food service industry. Sales growth for the past five years has averaged 14.9%, with a 26.0% increase for the current nine months. The recent increase in cash flow financed an upgrade in plant facilities to support future growth, and strengthened the company's financial position. YoCream continues to outperform the industry and provide a stable base for continued growth through solid long-term customer relationships and the marketing of new innovative products.

Key Manager Statement

"Our entrepreneurial spirit has driven the success we are enjoying, along with exceptional products and the intense service we provide to customers. Now our recent alliance with the Dannon Company, Inc. opens a new array of opportunities for increased sales and market share."

John Hanna, Chairman & CEO

Diedrich Coffee Inc. • DDRX • Specialty Coffee

Irvine, CA • IR Contact: Matt McGuinness • 949-260-6737
www.diedrich.com



Diedrich Coffee specializes in sourcing, roasting and selling the world's highest quality coffees through multiple channels of distribution. The company's two primary brands are Gloria Jean's Coffees, the nation's leading chain of mall-based specialty coffee stores and Diedrich Coffee, with coffeehouses in California, Colorado and Texas. The company's 386 retail outlets, the majority of which are franchised, are located in 37 states and 10 foreign countries. Diedrich Coffee also sells its coffees through wholesale accounts including grocery stores, office coffee service distributors, restaurants and specialty retailers and via the Internet.

Key Manager Statement

"We owe our success to the hard work and customer service orientation of our management, retail operations support team, manufacturing and whole distribution team and franchisees. The specialty coffee market grew to \$7.76 billion in 2001, and commanded 31% of the total U.S. coffee market, up from 17% in 1989 according to the National Coffee Association. We believe we are well positioned to benefit from this growth as one of the market leaders."

Phil Hirsch, CEO & President

21st Century Holding Company • TCHC • Insurance

Plantation, FL • IR Contact: Becky Campillo • 954-308-1257
www.fedusa.com



21st Century Holding Company is guiding to \$1.25 per share on a GAAP basis in calendar year 2002 ending September 30th and to \$2.00-\$2.15 per share in 2003 and \$2.50-\$3.00 per share in 2004. This financial services holding company owns two property and casualty insurance companies, a managing general agency, 38 Fed USA financial services franchises, 22 company owned stores, a finance company, a tax company and other related financial services companies. This is a penny stock, but a company with real revenue and earnings growth that management believes will grow in excess of 20% per year into the future.

Key Manager Statement

"Our company, due to favorable insurance trends, sees tremendous opportunity and is positioned for real growth on a go forward basis. We believe that our franchise and insurance model can be leveraged across the country and we will increase profitability as we go."

Edward J. Lawson, President & CEO

Cray Inc. • CRAY • Supercomputers

Seattle, WA • IR Contact: Kenneth Johnson • 206-701-2000
www.cray.com



Cray Inc. is the premier provider of supercomputer solutions that tackle the world's most challenging technical problems for government, industry and academia. Cray has played a significant role in the reemergence of U. S. supercomputing, as the only company dedicated solely to high-bandwidth high-performance systems. Cray now offers the broadest variety of products and services to the high-performance market. The new Cray X1™ system is expected to be the world's most powerful "extreme performance" supercomputer product.

Key Manager Statement

"In 2002 Cray has become a highly-competitive, operating-stage company thanks to the dedicated talent of our employees and the increased confidence of our customers and investors. We have improved our profitability and capital structure, and increased our market share. Demand for our new Cray X1™ system is very encouraging, and we expect growing revenues in excess of \$200 million in 2003."

James E. Rottsolk,
Chairman, President & CEO

THE EQUITY INVESTOR'S 26-WEEK MICRO-CAP REVIEW

Rainmaker Systems, Inc. • RMKR • Business Process Outsourcing

Scotts Valley, CA • IR Contact: Leslie Green • 650-470-0200
www.rmkr.com



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Key Manager Statement

"In a challenging economy, we have delivered improving financial results, sequential revenue growth, year-over-year revenue growth, and positive cash flow. With the maintenance market strengthening, the increasing market acceptance of our new services and continuing expansion within our client base, we are confident that our growth will continue."

Michael Sifton, CEO

Daktronics, Inc. • DAKT • Electronic Displays & Scoreboards

Brookings, SD • IR Contact: Mark Steinkamp • 800-605-DAKT (3258)
www.daktronics.com • investor@daktronics.com



Daktronics designs, manufactures, markets and services a broad line of electronic displays that include scoreboards, electronic message centers, and large screen video displays, which can be integrated and linked with other information systems through proprietary control software. Daktronics is known as the premier technology leader with the highest quality products and on-going customer support.

Sales and EPS have increased at a CAGR of 19% and 23%, respectively, over the past five fiscal years. The company expects to continue profitable growth at similar rates. With tens of thousands of electronic displays and scoreboards installed around the U.S. and in 70 countries, chances are you've seen Daktronics products at work in sport, commercial and transportation applications.

Key Manager Statement

"Daktronics is a leader in the emerging electronic, large-display market, providing cutting edge display and control technology. An attractive and unique portfolio of products, along with a customer-intimate marketing approach, allows us to best meet the needs of a growing marketplace. We excel at developing new products, new applications, and transitioning existing technology into new markets."

James Morgan, CEO & President

Infocrossing, Inc. • IFOX • IT Outsourcing

Leonia, NJ • IR Contact: Bill McHale • 201-840-4732
www.infocrossing.com



Infocrossing, Inc. is a premier provider of selective IT outsourcing services, including mainframe outsourcing, midrange and NT/Unix management, business continuity services, business process outsourcing and IT infrastructure consulting. With over 18 years of experience managing large, mission-critical IT systems, Infocrossing's selective outsourcing methodology is a flexible approach that provides companies with the opportunity to reduce their operating costs, without having to outsource an entire IT department.

Key Manager Statement

"Infocrossing has experienced tremendous growth as the market has embraced our selective outsourcing solutions to reduce costs while maintaining control over IT operations. Infocrossing's clients recognize greater savings, improved service levels and higher satisfaction from their outsourcing decision. Over the previous 12 months, the company signed over \$60M in new contracts, expanded into a second data center, doubled revenue, and built a robust sales pipeline providing strong momentum into 2003."

Zach Lonstein, Chairman & CEO

USANA Health Sciences, Inc. • USNA • Nutrition and Health

Salt Lake City, UT • IR Contact: Riley Timmer • 801-954-7100
www.usanahealthsciences.com • investor.relations@us.usana.com



USANA Health Sciences, Inc. is a rapidly growing developer and manufacturer of high quality, science-based nutritional personal care, and weight management products. USANA distributes its products internationally through network marketing, creating a wealth of opportunities for its independent associates. From inception in 1993, USANA has experienced remarkable growth and now expects 2002 sales to top \$130 million. Over the last few years, the company has significantly strengthened its balance sheet, primarily as a result of strong operating cash flows. Simultaneously, USANA has increased production capacity, expanded internationally and continued an aggressive share buyback program.

Key Manager Statement

"USANA is at the forefront of scientific nutritional research with products designed to provide optimal nutrition and antioxidant protection for improved health and quality of life. Strengthening our commitment to the corporate/associate partnership has been a key driver for recent success. With four consecutive quarters of positive earnings increase behind us, we are moving quickly to create additional revenue and provide opportunities for our stakeholders."

Dave Wentz, President

Steel Technologies Inc. • STTX • Steel Processors

Louisville, KY • IR Contact: Joe Bellino • 502-254-0204
www.steeltechnologies.com



Steel Technologies

Steel Technologies is a customer driven, growth oriented company that provides value-added resources and services to its customers. The company

world-class facilities are strategically located throughout the United States and Mexico. Steel Tech processes flat rolled steel to precise specifications for customers in a variety of steel consuming industries including automotive, appliance, lawn and garden, office equipment, agricultural, machinery and consumer goods.

With over 1,000 employees, the Steel Tech team is committed to producing the highest quality products and service available in the industry. Steel Technologies is committed to operational excellence in every aspect of their business.

Key Manager Statement

"In 2002, we recorded record sales and earnings. Our solid earnings momentum in recent quarters has been the result of significant market share growth and sharpened operating performance. We are developing leaders at every level of our organization focused on improving our performance and expanding the value we bring to our customers. Our people and operations are well positioned to fuel our future growth."

Brad Ray, Chairman & CEO

RTW, Inc. • RTWI • Insurance (Workers' Compensation)

Bloomington, MN • IR Contact: Jeff Murphy • 800-RTW-ACIC
www.rtwi.com



RTW, Inc. provides proprietary products and services to employers to effectively manage workers' compensation costs. RTW's proprietary techniques include: ID15®, designed to identify injured employees likely to "get stuck" in the work comp system, and the RTW SOLUTION®, designed to return injured employees to transitional work or regular duty as soon as possible and reduce an employers' total work comp expenses. The result — reduced employer work comp costs as injured employees return more quickly to productivity at a claim cost 42% below industry average.

Key Manager Statement

"Our systems provide us a key competitive advantage. In 2002, we focused on improving our balance sheet by positioning RTW for sustainable profitability in markets we know well. Our premium rates increased sequentially since 1999, growing 10% in 2002 alone. With a stronger balance sheet, a focused and experienced executive team, increasing premium rates and added fee-for-service product offerings, we are well positioned for improved profitable growth."

J. Alexander Fjelstad,
President & CEO

THE EQUITY INVESTOR'S 26-WEEK MICRO-CAP REVIEW

National Technical Systems Inc. • NTSC • Business Services

Calabasas, CA • IR Contact: Aaron Cohen • 818-591-0776
www.ntscorp.com

NTSC
National Technical Systems Inc., the nation's largest independent testing laboratory, provides integrated testing, certification, quality registration, systems evaluation and IT staffing services to organizations in the aerospace, defense, telecommunications, information technology (IT) and high technology markets.

The company's Engineering and Evaluation Group specializes in testing advanced systems for such clients as NASA's Jet Propulsion Laboratory, TRW and Boeing, and is involved in a number of Homeland Security and national defense programs. The group is certified for net-compliance testing by telecommunications companies like Verizon and its computer testing of multimedia products, computer games, cameras, printers, scanners and PDAs. The company's IT Staffing Group provides temporary and permanent placement of IT professionals.

Key Manager Statement

"We are seeing improvement in all industries we serve, particularly aerospace, defense and commercial certification. Our staffing business, where we just completed the acquisition of the IT staffing division of a subsidiary of Fluor Corporation, is integrating seamlessly and is able to assist in projects that evolve from cross-selling to customers in all our operating units."

Bill McGinnis, President & COO

Delta Woodside Industries, Inc. • DLW • Textiles

Greenville, SC • IR Contact: W. H. Hardman, Jr.
bill.hardman@deltamills.com • www.deltawoodside.com



Delta Woodside Industries, Inc.

Delta Woodside, through its Delta Mills operating division, manufactures and sells a broad range of finished apparel fabrics primarily to branded apparel manufacturers and resellers, and private label apparel manufacturers for major retailers. Delta Mills also manufactures and sells camouflage fabric and other fabrics used in apparel sold to the United States Department of Defense.

Key Manager Statement

"The extended period of distress in the textile and apparel industry, coupled with unfavorable government trade agreements and a general economic downturn have created a competitive environment unlike any we have experienced. Many of the forces at work have been outside of our control. Therefore, in order to survive and become more competitive on a worldwide scale, we have attacked the fundamentals of our business to capture improvements in the areas we can control. Namely, we have focused on increases in sales volume, reducing operating cost and reducing debt. This focus has resulted in a return to profitability for the last two quarters."

William F. Garrett, CEO

LESCO, Inc • LSCO • Chemical

Longsville, OH • IR Contact: Jeffrey Rutherford • 440-783-9250
www.lesco.com



OW WITH US™

LESCO, Inc., with 2001 sales totaling \$504.3 million, is the nation's leading provider of lawn care and golf course products to the \$5.0 billion professional turf care industry. LESCO serves more than 100 customers worldwide, through LESCO Service Centers® stores, 77 Stores-on-Wheels®, 62 lawn care representatives, 40 golf sales representatives and 13 National Account representatives. During 2002, the company aggressively implemented expense and cost controls designed to improve margins and cash flows. The company has not opened new stores since recently announced its intention to open 5 to 25 new stores in 2003.

Key Manager Statement

"We have a very scalable, low capital intensive store model and our current stores have tremendous four-wall returns of over 25%. With the expense and capital disciplines we have implemented and the opening of new stores, we have an operating model which should generate great growth and returns."

**Michael P. DiMino,
President & CEO**

Medix Resources, Inc. • MXR • Healthcare IT

New York, NY • IR Contact: Andrew Brown • 212-697-2509 x324
www.medixresources.com

Medix Resources specializes in developing, marketing, and deploying Web-enabled, interactive services for the healthcare industry. Its proprietary technology enables pharmacy benefit managers ("PBMs") and diagnostic laboratories to exchange critical information and perform transactions directly with physicians over the Internet.

Medix provides physicians real-time, point-of-care ability to verify eligibility, check patient-specific formularies, review medication histories, prescribe, place lab orders, and get results — all electronically, through the use of a handheld device or a desktop computer.

Medix's Universal Interface eliminates the need for physician's staff to re-key data by connecting virtually any software systems. Medix's customers include Medco Health Solutions, Express Scripts, Inc. and WellPoint Pharmacy Management.

Key Manager Statement

"Medix is at the vanguard of an online revolution in healthcare that will minimize dangerous errors, increase efficiency, and lower costs. Our ability to collaborate among many healthcare constituents addresses an enormous market. Our model generates revenues on a per transaction basis, without forcing physicians to invest in new systems. Accordingly, I believe that Medix is an investment opportunity that comes along once in a lifetime."

Darryl R. Cohen, CEO

26-WEEK MICRO-CAP REVIEW COMPANY DIRECTORY

COMPANY	PHONE #	COMPANY	PHONE #
1st Century Holding Company	954-308-1257	Medix Resources, Inc.	212-697-2509
Ray Inc.	206-701-2000	National Technical Systems Inc.	818-591-0776
Elektronics, Inc.	800-605-DAKT	Rainmaker Systems, Inc.	650-470-0200
Delta Woodside Industries, Inc.	864-255-4127	RTW, Inc.	800-RTW-ACIC
Hedrich Coffee Inc.	949-260-6737	Steel Technologies Inc.	502-254-0204
Locrossing, Inc	201-840-4732	USANA Health Sciences, Inc.	801-954-7100
LESCO, Inc	440-783-9250	YoCream International	800-YOCREAM



HOW FUNDS VOTE SHOULDN'T BE A SECRET

BY ROBERT BARKER rb@businessweek.com

DOUG HAY, PROPRIETOR of a bed-and-breakfast in Mill Rift, Pa., owns mutual funds. After the funds cast proxy votes for or against directors of companies they own stock in, he wants to know how they voted. "There has to be accountability," he told me. On the other side of the globe in Kathmandu, Nepal, photographer Susan Stebbins, another mutual fund investor, agrees. "As we have more and more corporate power, as corporations become larger than nations, it becomes more important to have democratic institutions," she says. Hay and Stebbins are among hundreds of fund owners who have written the Securities & Exchange Commission this fall

to support a proposed rule that would force mutual funds to disclose their proxy votes. Yet as the public comment period draws to a close on Dec. 6, the fund industry, which manages 20% of the nation's stock holdings, is coming down against the proposal. It argues that the rule may be too costly, will impose burdens of disclosure not suffered by other institutional investors, and will foil their ability to nudge companies privately toward better governance.

The SEC's proposal, which cleared the panel unanimously in September, has united even industry leader Fidelity Investments and archrival Vanguard Group, which often portrays itself as more investor-friendly. Disclosure would "politicize" proxy voting, David Weinstein, Fidelity's executive vice-president for public policy, told me: "Unions and special-interest groups really want to obtain this information to influence how we vote proxies, not for the benefit of all shareholders." Vanguard Chairman John Brennan said: "There are significant downsides to the proposal and no upsides.... The millions of people who do trust [Vanguard] shouldn't bear the burden of the special-interest groups."

These are fair points. With Vanguard voting on some 250,000 proxy items last year, disclosure would doubtless add to costs. The flood of new information also would create all kinds of lobbying headaches or, depending on your perspective, opportunities. Yet to me, in looking after its own and asking investors simply to keep trusting them, the fund industry is missing a much graver problem. In 2002, more than two decades of implicit trust in Corporate America to look after the commonweal collapsed. To paraphrase Ronald Reagan: Trust demands verification.

Any complaints about the costs of disclosing the thousands of proxies cast by funds strike me as akin to worrying



about how much it might have cost to ensure accurate balloting in Florida in the last Presidential election. If it costs X to get the system to conform to people's wishes, then X must be paid. To do otherwise is to concede to some people's wishes—in this case, those who own funds—don't matter.

It's also fair to wonder how terrible more open and contentious campaigning in corporate proxy contests would be. Most of the time, a liberal argument is a good thing. The debate went back only to the debate early last year over Hewlett-Packard's merger with Compaq. Is the republic worth the off for it? Not the way I see it. The merger winds up proving foolhardy. Shareholders will have no one to blame.

Fidelity's Weinstein told me he fears disclosing funds' proxy votes would create a "tyranny of the minority," as special interests begin pressuring funds to support

other than financial returns. That's a risk. Meantime, a greater risk to our economy is that individual investors, one by one, conclude they can't trust mutual funds to cry foul when they see bloated executive pay packages, incompetent audit committees, and other hallmarks of corporate cronyism.

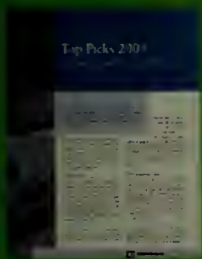
Are fund managers the reason that 2002 gave investors much grief? No. But in repairing the broken trust between America's private-sector leaders and the individuals who work and savings support them, disclosure of funds' proxy votes is one small, but mandatory, step. Funds are, after all, the investment of the middle class. "If we don't make the kind of changes, then ultimately the whole stock market system is not going to work," Stebbins says. "It's needed. People to have faith in the system." Amen.

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SOME MARKET PROS SEE JUICIER RESULTS AT APPLE COMPUTER NEW-PRODUCT DEALS COULD PUT MICROVISION IN THE BLACK. DENDREON'S PROSTATE REMEDY IS A STEP CLOSER TO APPROVAL

BY GENE MARCIAL

Sweeter at Apple?

Apple Computer (AAPL) is one stock that has yet to join the market's resurgence from October lows—and the more recent tech rally. Trading at 26 in April, Apple has fallen to 15. It hit 75 in 2000, when it earned \$2.18 a share on sales of \$8 billion. In 2001, sales tumbled to \$5.3 billion, and a loss of \$25 million drove the stock down to 14. But in fiscal 2002 ended Sept. 30, Apple snapped back: It earned \$65 million, or 33¢ a share, on sales of \$5.7 billion—but investors weren't biting. The sluggish economy and stiff price pressure in PCs have cooled their interest.

Still, some pros believe Apple will kick higher starting this month. Says one hedge-fund manager who has been buying: "Any uptick in sales [which he expects soon] will catapult the stock back to the mid-20s." An upgrading of computers bought about five years ago will help push sales up, he says. Traffic at Apple Stores has been good, he notes, aided by new products, including iPod, an MP3 player.

Few analysts are high on Apple, but Charles Wolf of Needham, who rates the stock a buy, says the company's foray into retail mall outlets has attracted visitors at a "rapid pace." He expects Apple to earn 40¢ a share in 2003, vs. Thomson First Call consensus of 24¢.

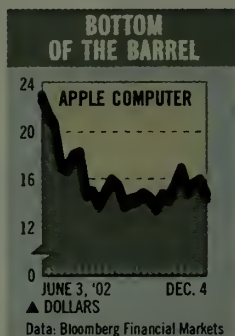
Kevin Hunt of Thomas Weisel Partners says the stock, at the low end of its historic range and cheaper than its peers, is attractive long-term. "Apple is poised to reemerge as a growth story once overall PC spending resumes," he says.

Sharpening Microvision's Focus

Microvision (MVIS), trading at 5.65 a share, may not stay a micro-cap for long. So say some investors who are excited by the company's miniaturized optical scanning-and-imaging technology—which has attracted Boeing, Canon, Johnson & Johnson, BMW, and medical-device maker Stryker. They are partners in developing new products—from displays mounted on the helmets of helicopter pilots to miniature opticals in digital cameras and wireless phones. CEO Richard Rutkowski explains that, in a digital camera, Mi-

crovision's scanner can provide a better full-color image in viewfinder than can be seen on a laptop computer screen. Says this ability to show an image at its print resolution as a photographer snaps a picture will make it the digital camera of the future.

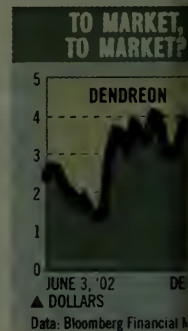
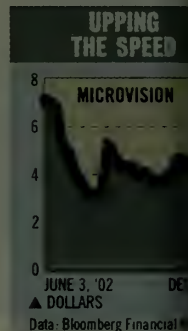
Sources say Microvision is set to sign an agreement with Canon for use of Microvision's technology. Paul Sethi of Vertical Ventures, which owns shares, says the company has yet to make money, but he sees sales rising to \$18 million this year and \$30 million in 2003. Sethi expects Microvision to post profits in 2004, with sales jumping to \$50 million.



A Cancer Drug Nears the Home Stretch

Dendreon (DNDN), which develops vaccines to boost a patient's immunity against cancer, is soon set to get a big lift from the Food & Drug Administration. The FDA is expected to announce that Dendreon may speed up its Phase 3 clinical trials on Provenge, a therapeutic vaccine for hormone-resistant prostate cancer. That would expedite Dendreon's application for final approval of Provenge.

Prostate cancer is the most common cancer among American men, says Mark Monane of investment firm Needham, who rates the stock a buy. Trading at 11 last year, the stock is now at 4, reflecting the biotech slump. Results of Provenge's first Phase 3 trial showed good results, says Mitchell Gold, who takes over as CEO on Jan. 1, 2003. The second Phase 3 trials now under way—with only advanced-prostate-cancer patients enrolled—will provide pivotal evidence needed to seek FDA approval. Overall, Provenge was well tolerated, says Gold, with the most common side effects being chills and fever, which were most often infusion-related. Needham's Monane expects the company to be in the black by 2004, when he forecasts earnings of 88¢ a share.



BusinessWeek online

Read Gene Marcial's Inside Wall Street Online column Tuesday afternoons at www.businessweek.com today.htm. And see him Fridays at 1:40 p.m. EST on CNN's *The Money Gang*.

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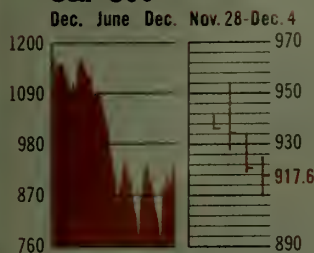
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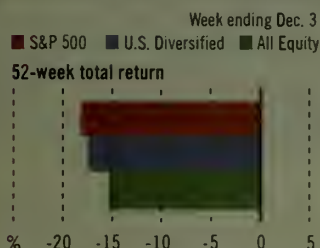
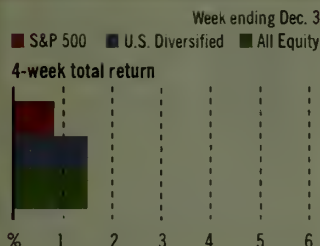


COMMENTARY

After staging a rally on Thanksgiving eve, investors returned from the holiday in a bearish mood. Despite a strong start to the holiday shopping season and signs of an economic bottom, war worries and fears of weak corporate profits are again weighing on stocks. For the week, the Dow, the S&P 500, and NASDAQ lost 2.2%, 2.3%, and 5.0% respectively.

Data: Bloomberg Financial Markets (Reuters)

MUTUAL FUNDS



Data: Standard & Poor's

U.S. MARKETS

	DEC. 4	WEEK	% CHANGE YEAR TO DATE	LAST 12 MONTHS
S&P 500	917.6	-2.3	0.5	-20.1
Dow Jones Industrials	8,737.9	-2.2	0.7	-12.8
NASDAQ Composite	1430.4	-3.9	-1.0	-26.7
S&P MidCap 400	440.9	-2.1	0.7	-13.2
S&P SmallCap 600	202.2	-2.1	0.6	-12.9
Wilshire 5000	8,671.4	-2.3	0.4	-19.0

SECTORS

BusinessWeek 50*	735.0	-0.9	-22.8	-23.4
BusinessWeek Info Tech 100**	421.2	-2.8	-26.4	-26.7
S&P/BARRA Growth	474.4	-1.8	0.7	-20.2
S&P/BARRA Value	439.9	-2.8	0.3	-20.3
S&P Energy	184.1	0.8	3.2	-12.9
S&P Financials	308.8	-2.2	0.7	-13.1
S&P REIT	91.0	-0.1	0.8	-2.6
S&P Transportation	171.8	0.0	2.8	-12.8
S&P Utilities	92.0	-2.4	-1.8	-36.9
GS&I Internet	82.1	-6.8	-4.2	-21.8
PSE Technology	488.5	-5.7	-2.0	-28.9

*Mar. 19, 1999=1000 **Feb. 7, 2000=1000

BEST-PERFORMING GROUPS

	LAST MONTH %	LAST 12 MONTHS %
Paper Packaging	29.6	34.4
Computer Stores	17.8	23.1
Networking Equipment	17.1	20.2
Automobiles	15.7	16.1
Telecomms. Equipment	12.4	15.0

EQUITY FUND CATEGORIES

4-WEEK TOTAL RETURN	%	52-WEEK TOTAL RETURN	%
LEADERS		LEADERS	
Technology	6.6	Precious Metals	47.2
Diversified Pacific/Asia	5.8	Real Estate	5.7
Diversified Emerging Mkts.	5.5	Diversified Emerging Mkts.	1.9
Communications	4.8	Diversified Pacific/Asia	-0.1
LAGGARDS		LAGGARDS	
Health	-1.9	Communications	-36.8
Precious Metals	-1.7	Technology	-36.1
Japan	-1.0	Health	-28.8
Utilities	-0.4	Large-cap Growth	-23.2

EQUITY FUNDS

4-WEEK TOTAL RETURN	%	52-WEEK TOTAL RETURN	%
LEADERS		LEADERS	
Firsthand Tech. Innovators	21.6	First Eagle SoGen Gold	80.9
New York Equity	21.2	Monterey OCM Gold	65.8
Jacob Internet	18.8	Tocqueville Gold	61.8
Apex Mid Cap Growth	17.3	Gabelli Gold	61.4
LAGGARDS		LAGGARDS	
Fidelity Sel. Medical Oel.	-13.0	ProFunds UltraWireless	-74.9
ProFunds UltraShort OTC	-10.9	ProFunds UltraOTC Inv.	-65.1
Rydex Dynam. Vent. 100	-10.9	Rydex Dynam. Veloc. 100	-64.1
CGM Capital Development	-8.0	Wrlld. GenomicsFund.com	-62.4

GLOBAL MARKETS

	DEC. 4	WEEK	% CHANGE
S&P Euro Plus (U.S. Dollar)	826.3	-6.5	-2.1
London (FT-SE 100)	4048.6	-2.3	-0.6
Paris (CAC 40)	3199.8	-3.4	-1.1
Frankfurt (DAX)	3320.8	-0.8	-0.2
Tokyo (NIKKEI 225)	9006.7	1.5	0.2
Hong Kong (Hang Seng)	9995.7	0.5	0.1
Toronto (S&P/TSX Composite)	6610.4	0.1	0.0
Mexico City (IPC)	6187.7	1.0	0.2

FUNDAMENTALS

	DEC. 3	WK. AGO
S&P 500 Dividend Yield	1.72%	1.73
S&P 500 P/E Ratio (Trailing 12 mos.)	29.9	29.7
S&P 500 P/E Ratio (Next 12 mos.)*	16.7	16.6
First Call Earnings Revision*	-2.40%	-2.62

TECHNICAL INDICATORS

	DEC. 3	WK. AGO
S&P 500 200-day average	982.3	984.9
Stocks above 200-day average	28.0%	25.0
Options: Put/call ratio	0.70	0.69
Insiders: Vickers NYSE Sell/buy ratio	1.70	1.95

WORST-PERFORMING GROUPS

	LAST MONTH %	LAST 12 MONTHS %
Health-Care Facilities	-14.4	Multi-Utilities
Motorcycles	-11.4	IT Consulting
Distillers & Vintners	-9.7	Telecomms. Equip.
Health-Care Services	-8.7	Instrumentation
Managed Health Care	-7.9	Tires & Rubber

INTEREST RATES

KEY RATES

	DEC. 4	WEEK AGO
MONEY MARKET FUNDS	1.14%	1.17%
90-DAY TREASURY BILLS	1.21	1.22
2-YEAR TREASURY NOTES	1.98	2.07
10-YEAR TREASURY NOTES	4.15	4.26
30-YEAR TREASURY BONDS	5.00	5.11
30-YEAR FIXED MORTGAGE†	6.08	6.05

†Bank

BLOOMBERG MUNI YIELD EQUIVALENTS

Taxable equivalent yields on AAA-rated, tax-exempt municipal bonds, assuming a 30% federal tax rate.

	10-YR. BOND
GENERAL OBLIGATIONS	3.98%
TAXABLE EQUIVALENT	5.69
INSURED REVENUE BONDS	4.08
TAXABLE EQUIVALENT	5.83

THE WEEK AHEAD

FOMC MEETING Tuesday, Dec. 10, 9 a.m. EST ► The Federal Reserve Board's Open Market Committee will meet to set monetary policy. Economists surveyed by MMS International unanimously expect the federal funds rate will remain at 1.25%.

CURRENT-ACCOUNT DEFICIT Thursday, Dec. 12, 8:30 a.m. EST ► The U.S. current-account deficit is expected to have reached \$131 billion in the third quarter, after surging to \$130 billion during the previous quarter.

RETAIL SALES Thursday, Dec. 12, 8:30 a.m. EST ► Retail sales probably climbed 0.4% in November after holding steady in October. Excluding vehicles, November sales probably increased by a similar 0.4%, following a sharp 0.7% rise in October.

EXPORT-IMPORT PRICES Thursday, Dec. 12, 8:30 a.m. EST ► Import prices during October are forecast to have fallen by 0.3%, while export prices most likely edged up 0.1%.

BUSINESS INVENTORIES Friday, Dec. 8, 8:30 a.m. EST ► Inventories probably increased by a further 0.2% in November after increasing 0.5% in October.

PRODUCER PRICE INDEX Friday, Dec. 8, 8:30 a.m. EST ► Producer prices for finished goods very likely rose 0.1% in November. Even excluding food and core prices probably rose by 0.1% in October, higher energy costs pushed up 1.1%, although higher vehicle prices pushed the core index up 0.5%.

BUSINESSWEEK FIFTY

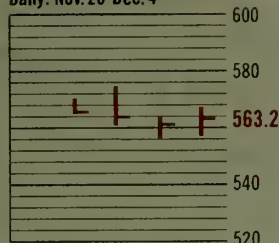
June

Dec.

Daily: Nov. 28-Dec. 4



Weekly

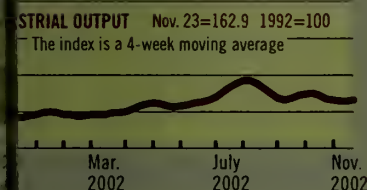


50 turned in a relatively strong performance, falling 0.9% for the week ending Dec. 4. Setting the such health care stocks as AmerisourceBergen, up 7.9%, and Wellpoint Health Networks, adding 4.1%. The declining stocks was energy provider Calpine, which fell 15.8%, and retailer Kohls, which lost 11.5%. It is that the holiday shopping season may prove disappointing.

WEEKLY PERFORMANCE			% CHANGE			% CHANGE		
COMPANY	WEEK	SINCE 3/1/02	RANK	COMPANY	WEEK	SINCE 3/1/02	RANK	COMPANY
Johnson & Johnson	-1.7	-6.8	26	Tenet Healthcare	3.3	-51.3		
3M	-0.9	-9.1	27	Household International	-0.6	-45.4		
Amgen	-2.2	-24.5	28	WellPoint Health Networks	4.1	13.5		
Boehringer Ingelheim	-3.5	-9.2	29	Washington Mutual	-2.5	8.9		
Cardinal Health	5.2	-24.8	30	Duke Energy	-1.0	-44.2		
Centex	-12.5	-37.6	31	Kohl's	-11.5	-8.7		
Chesapeake Energy	0.8	-18.1	32	Bed Bath & Beyond	4.3	7.3		
Clorox	0.2	-8.1	33	Cardinal Health	2.8	-3.2		
ConocoPhillips	-0.7	-40.3	34	Centex	-4.3	-16.9		
Cummins	7.9	-6.7	35	American Electric Power	-4.0	-37.7		
Danaher	3.3	14.6	36	Golden West Financial	-1.7	8.0		
Dell	-2.2	1.0	37	Stryker	3.4	4.8		
DuPont	-0.3	-48.0	38	Harley-Davidson	-3.6	-7.8		
Eastman Chemical	-0.7	-12.2	39	PepsiCo	2.6	-14.1		
ExxonMobil	-6.6	-95.6	40	Merck	-1.8	-4.1		
General Dynamics	0.9	-8.8	41	Apache	2.8	4.0		
General Electric	2.4	-16.7	42	Amerada Hess	1.1	-18.4		
General Motors	-1.4	34.8	43	KB Home	-7.1	-3.2		
H&M	3.3	-21.5	44	First Data	1.8	-12.7		
H&R	-15.8	-49.3	45	Tyco International	-3.4	-41.4		
International Petroleum	-0.4	2.5	46	International Game Technology	-3.8	11.9		
Kellogg	0.3	-0.1	47	Capital One Financial	-0.5	-30.0		
Kraft Foods	-5.6	-13.4	48	Electronic Data Systems	-6.1	-71.1		
Marathon Oil	1.7	-26.9	49	Nabors Industries	6.3	5.2		
Medtronic	-2.9	-10.8	50	Xcel Energy	-4.8	-57.1		

PRODUCTION INDEX

Change from last week: 0.3%
Change from last year: 1.9%



The production index rose for the first time in seven months. The calculation of the four-week moving average index jumped to 164.2, from 162.5. On an adjusted basis, six of the eight components increased. Lumber output showed the biggest increase, followed by strong increases in both autos and trucks. Moderate rises came in coal, electric-power, and rail-freight traffic. Only steel and refining declined.

Each of the index components is at www.businessweek.com.
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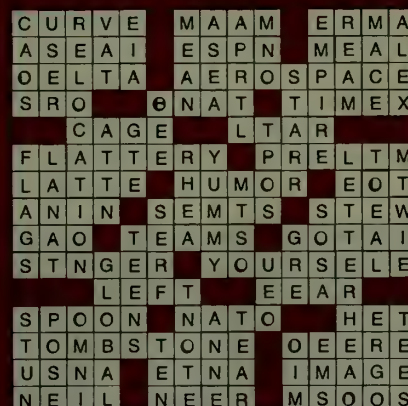
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LESSONS OF THE GREENSPAN ERA

America has had an odd assortment of Federal Reserve Chairmen. It has had tough ones, such as Paul A. Volcker, who crushed inflation mercilessly in the early 1980s. It has had political ones, such as Arthur F. Burns and G. William Miller, who catered to the election needs of the White House. It has had clueless ones, such as Eugene Meyer, who mistakenly tightened monetary policy after the 1929 stock market crash and helped push the U.S. into the Depression. But it wasn't until Alan Greenspan that the nation had a Fed chairman who combined a devotion to fighting inflation with a willingness to let the economy run, unleashing the benefits of higher productivity.

Greenspan's long tenure as Fed chairman will likely end in less than two years, and his legacy is beginning to generate intense discussion (page 94). But a debate about the rights and wrongs of specific policy moves in the 1990s pales in significance to his greatest achievement. Before him, economists saw the Fed as having a single role—to take away the proverbial “punch bowl” at the economic party by raising interest rates when the economy overheated and inflation rose. Greenspan applied a more dynamic analysis to the economy, understanding before most that it had evolved in the '80s and '90s into a more productive, flexible, and elastic system. He then redefined the goal of the Fed as allowing faster growth while guarding against inflation. Greenspan encouraged the rise of a new risk-taking investor class that made the stock market central to raising capital for innovation, and to higher productivity, growth, and prosperity in America.

Along the way, Greenspan broke the Philips Curve, the principle that inflation inevitably rises when unemployment falls. This conventional wisdom led economists to believe that unemployment should not be allowed to drop below 6%. But under Greenspan unemployment fell below 4% and inflation virtually disappeared. To his credit, Greenspan foresaw that information technology in the '90s was raising productivity levels and the potential speed limit of the U.S. economy. He had the courage to act on his convictions against strong criticism among conservative economists both within and outside the Fed, and allowed the economy to grow faster than they thought possible. This lowered unemployment to new levels, generated enormous wealth for the rich and middle class, and created huge opportunities for millions of poor people and immigrants.

THE UPSIDE OF VOLATILITY

And yes, it did lead to a bubble. Yet it is important to note that, despite the recession and such unexpected shocks as September 11 and the wave of corporate scandals, most of the gains of the boom were not lost in the bust. Stock prices measured by the Standard & Poor's 500-stock index remain twice as high today as they were when the boom started in 1995. With the exceptions of the telecom and tech markets, the economic pain from the bursting of the '90s bubble has been substantial-

ly less than after previous bubbles in both the U.S. and J.

But what of future Fed policy? Greenspan believes Fed's successful monetary policy has reduced inflation and impact of recession to the point where people are willing to take much more risk. But the price may be more bubbles and busts, more bubbles. Greenspan believes this growth volatility is a fair exchange for long-term gains in capital investment, productivity, economic growth, and prosperity that can be managed by deft policy.

WHAT COMES NEXT?

There is fear in Washington that the Greenspan era will end with Greenspan. Will the next chairman be able to follow the entrails of economic data the way Greenspan can? Will the next person act fast enough to temper the impact of burst bubbles? No one can be certain, so a group of economists is calling for a post-Greenspan Fed to adopt “inflation-targeting.” They want the next chairman of the Fed to publicly set a target range for inflation and report to Congress on how well the Fed is meeting the goal. Inflation targets would ensure that the Fed reins in the economy if inflation heats up, and boost the economy if inflation falls too low and becomes deflation. Inflation-targeting would put policy on autopilot and reduce uncertainty. It would also, believes Greenspan, force the Fed into a straitjacket. The Fed would have to act on historical data and ignore significant changes in the economy. We think Greenspan is right on this one.

A second group of economists, the “anti-bubblists,” are skeptical about Greenspan's acceptance of bubbles as a price to pay for long-term growth. They want the next Fed chairman to move early against any big run-up in asset prices in stocks, real estate, or even the dollar. They criticize Greenspan for not boosting interest rates or raising margin requirements to curb stock purchases in the late '90s, when such actions might have prevented a bubble. This group fears that bubbles lead to deadly deflation, and must be fought, not accepted.

Greenspan believes that the price of puncturing bubbles is too high. Better to wait until bubbles burst and manage the consequences, softening the economic blow by loosening monetary policy very quickly. In speeches, Greenspan has suggested that had it not been for unanticipated events—September 11 and corporate corruption—the economy might have already recovered from the damage of the bubble popping. Perhaps Greenspan was right about productivity. It remains to be seen whether he is right about bubbles, though we suspect he is.

Greenspan served as Fed chairman under Presidents R. Reagan, George H. W. Bush, Bill Clinton, and George W. Bush. He leaves a powerful legacy of using flexible monetary policy to generate a high-growth, high-risk economy. His keen intellectual curiosity, his economic insight, and his willingness to contravene conventional wisdom will mark his years in office. Whoever replaces him, when the day finally comes, should understand that legacy and the benefits it has bestowed on the nation.



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The Rise and Fall of **DENNIS KOZLOWSKI**

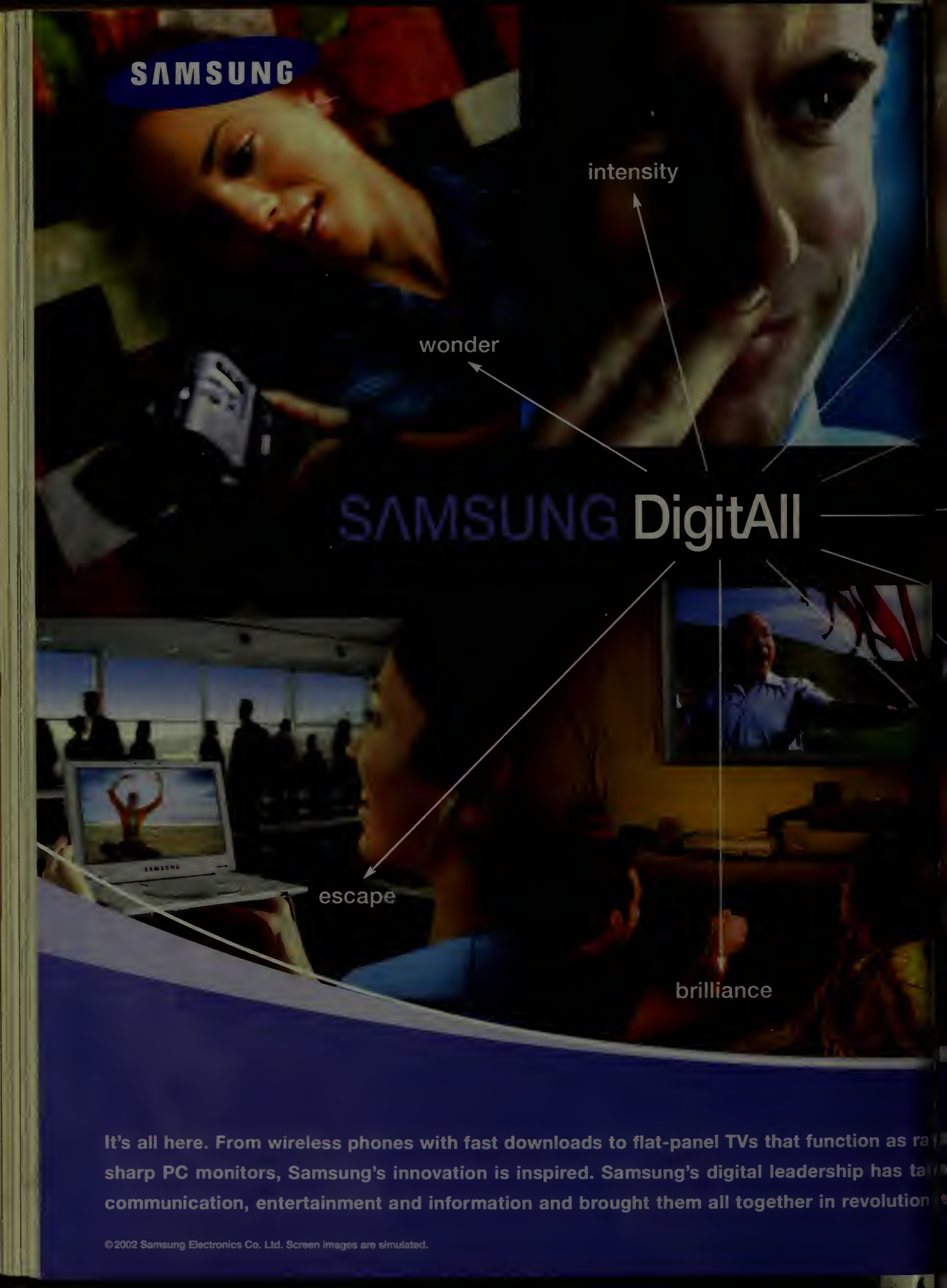
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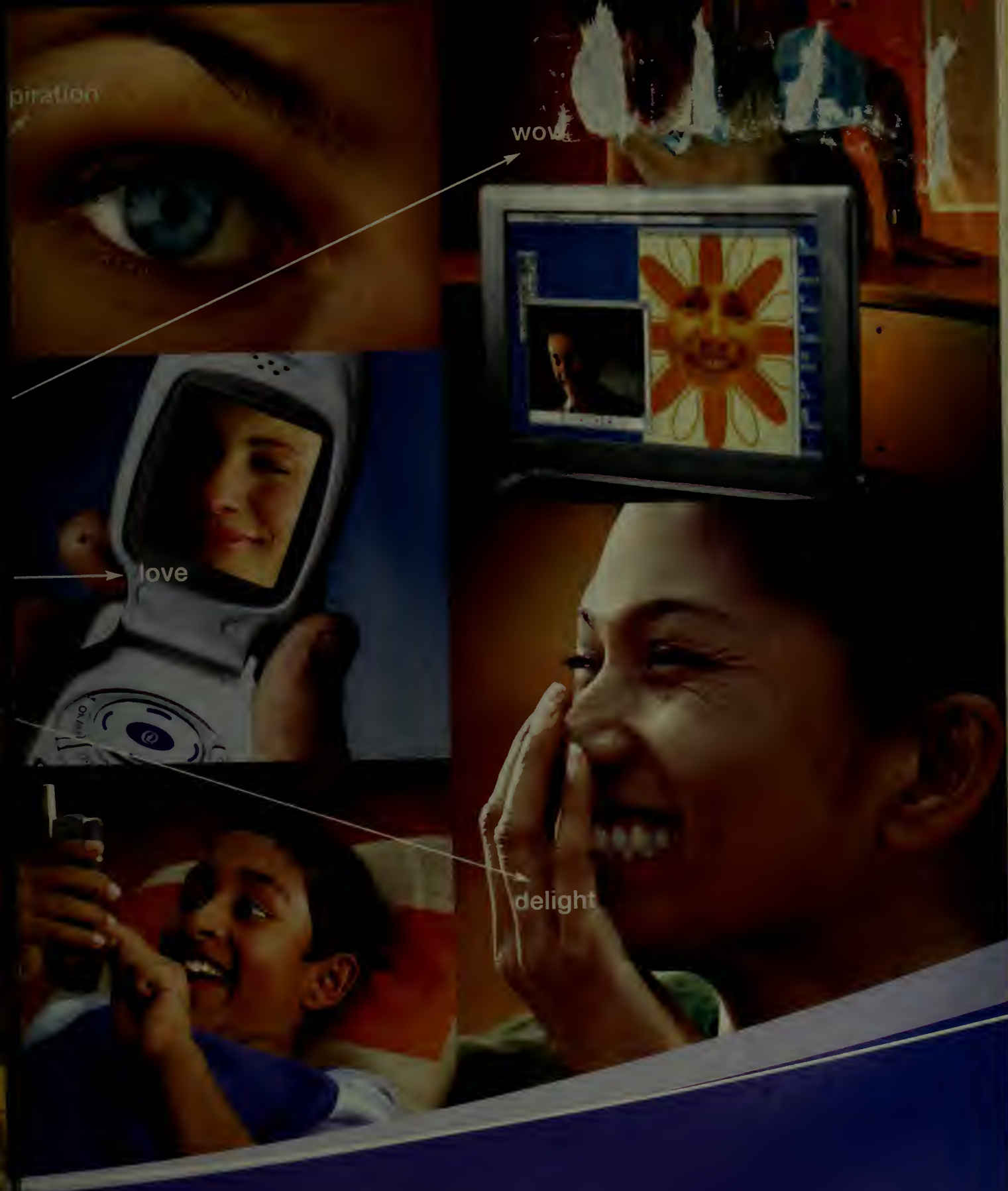
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DECLINE OF A CEO
Why did Dennis Kozlowski do what he did, revealing how the man behind the Tyco scandal came to be the Tyco scandal?
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64 THE RISE AND FALL OF A CEO

Just last year, Dennis Kozlowski proclaimed his desire to be remembered as the world's greatest executive. Indeed, for most of his 27 years at Tyco International Ltd., Kozlowski was an enterprising and effective manager. As CEO, he became the most prolific corporate acquirer ever—gobbling up 200 companies a year at the height of his activity—and the rewards, for shareholders as well as for the boss, were outsized, to say the least. But that was before the arrest, the indictments, the stories of \$30 million mansions and \$6,000 shower curtains. Now, Kozlowski may well be remembered as a corporate rogue. How did he become so unhinged by greed? A revealing look at the man behind the Tyco scandal

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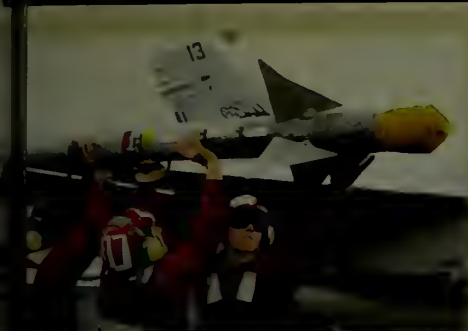
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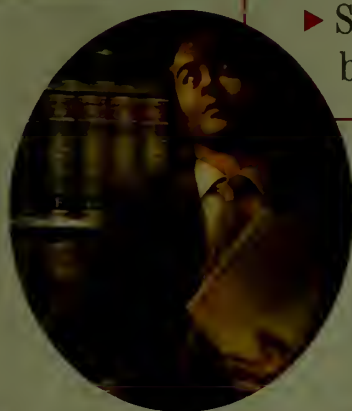
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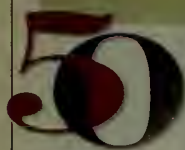
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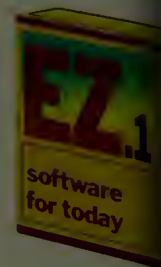
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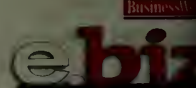
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Up Front

EDITED BY SHERIDAN PRASSO

TALK SHOW "It's time for all of us to pull up our socks."

—William Donaldson, on being picked to lead the Securities & Exchange Commission

CHARITY CASES

MIKE THE MUNIFICENT

OOPS! WHEN *BUSINESSWEEK* compiled its ranking of the 50 most generous philanthropists (Dec. 2), we missed a fairly prominent giver: New York City Mayor Michael Bloomberg. The reason: Except for a few public gifts to his alma maters, Bloomberg does little to publicize his generosity.

Yet he has given plenty, as is made clear from financial figures he has released as a politician. From 1997 through 2001, Bloomberg gave away \$330.2 million, a sum that would have made him No. 12 on our list. Last year alone, the founder of Bloomberg LP handed out \$122.5 million to 549 nonprofits, ranging from Habitat for Humanity to the Latino Commission on AIDS.

Bloomberg has given Johns Hopkins University more than \$100 million, making him the school's largest donor. It started with a \$5 gift in 1964, the year he graduated with an electrical engineering degree. He also has donated at least \$25 million to Harvard University, where he earned an MBA. Bloomberg's estimated \$420 million in lifetime giving is 11% of his current \$4.8 billion net worth.

John Byrne

PAY PACKETS

WITH RAISES LIKE THIS...

PITY NEXT YEAR'S PAYCHECK. With the profit picture still dreary, some companies are once again readjusting pay increases for 2003—and you can guess in which direction. According to a new survey by Mercer Human Resource Consulting, average performers should see salary increases of 3.5% next year, the smallest hikes in more than two decades, below even last year's 3.6%.

One reason is that compa-



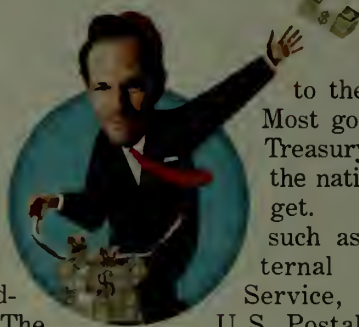
nies are passing on bigger chunks of health-care costs to employees—in many cases canceling out those raises or leaving workers with even smaller paychecks. Health-

care premiums have been rising so fast for the past years that Segal Co. estimates coverage will average nearly 25% of wages in more than five years. Companies deal with it by cutting of the large companies' surveys by Mercer in October. They whacked 2003 salary increases to offset health-care expenses, while an additional 9% considering the step. But the gravy days, pay increases used to be determined separately from benefits. Michelle Co.

FILTHY LUCRE

CRIME PAYS—THE TREASURY

CORPORATE MALFEASANCE may have pounded the portfolios of small investors, but it has been a windfall for government. The Securities & Exchange Commission tallied \$1.3 billion in corporate fines in the year ended Sept. 30, up from \$530 million a year earlier. That's not counting the billions collected by state attorneys general and the Justice Dept.



What happens to the money? Most goes to the Treasury to fund the national budget. Agencies such as the Internal Revenue Service, FBI, and U.S. Postal Service get a crack at recovering costs when their investigators help out Justice Dept. cases. The SEC keeps zilch. At the state level, what's not earmarked for victims goes to state coffers. There are exceptions. Nebras-

ka plans to use its share of a \$100 million settlement between Merrill Lynch and states to fund a business ethics professor at the University of Nebraska at Lincoln. And New York Attorney General Eliot Spitzer hopes to use some of the fines to hire outside investigators for his team.

As for bilked investors, officials say it often is worth tracking down millions of wronged shareholders to dole out a few bucks each.

Lorraine Woolf

THE LIST TOP OF THE FOOD CHAIN

Of 30,000 restaurants surveyed by Zagat, just a dozen got a near-perfect "29" rating. But none in ultra-picky New York or Los Angeles scored higher than "28." Here's a sampling of the best:

RESTAURANT/CITY	AVERAGE COST PER PERSON*
CHEZ JEAN-PIERRE BISTRO Palm Beach, Fla.	\$56
FOUNTAIN Philadelphia	66
FRENCH LAUNDRY Yountville, Calif.	113
GARY DANKO San Francisco	81

RESTAURANT/CITY	AVERAGE COST PER PERSON*
INN AT LITTLE WASHINGTON Washington, Va.	NA
LA COQUINA Orlando	\$51
LE BEC-FIN Philadelphia	85
ROVER'S Seattle	82





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Partner

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Lord Browne of Madingley, Group Chief Executive BP p.l.c.
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ушети
ь зачисти

корпоративная
стр. 2
Инвестиционные банки
открыт за крад Елгоп
стр. 7
Россию выведут из США
обращаясь от кураторов
стр. 4
Миллион Армян
в обилии
стр. 1
А. Спальню
демократии
стр. 4
США у жесточайших периодов
неизлечимости

Правда
Как операторам
повысить спрос
на налоговые услуги
стр. 8
ИД «Коммерсантъ»
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«Коммерсантъ»

Наранить
в толпу

Все же в яме

Up Front



ALLEN: Deductions on Charter

TAXING MATTERS

ALLEN'S LOSS IS ALSO HIS GAIN

SHAREHOLDERS OF CHARTER Communications deserve a good cry. The cable outfit's stock has fallen 90% this year, to \$1.62, amid probes by the Securities & Exchange Commission and a grand jury. But don't feel bad for Charter's largest shareholder, Microsoft billionaire Paul Allen. A 1998 agreement gives Allen the right to deduct Charter's losses from his holding company, Vulcan Ventures.

JARGON POLICE

PRIVACY RIGHTS—IN PLAIN ENGLISH

TELLING CONSUMERS ABOUT their privacy rights hasn't exactly been successful so far. Banks and credit card companies tried it in 2001. But the legal jargon was confusing, and many notices got thrown out. Now, health-care companies, drafting their own notices before an Apr. 14 federal deadline, want to make sure consumers actually read them.

So they're trying to give privacy notices a much-needed facelift. Some have drafted a template that summarizes, in plain English, key points such as how personal information is used and

investors, but you don't usually see them [this] big," he says. Allen could write off \$5 billion in Charter losses against Vulcan income through the end of 2003, says UBS Warburg analyst Aryeh Bourkoff, saving \$2 billion in taxes. Allen must repay the tax breaks if the cable company ever becomes profitable.

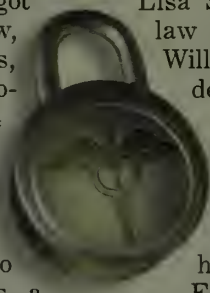
Not bad, huh? But the deal, which reduces Allen's holdings in the event of a liquidation, could force him to lose control of the cash-strapped company in a restructuring, says Bourkoff. Through Vulcan Ventures, Allen isn't commenting. *Ronald Grover*

how consumers can control the use of their medical records. "The idea is to make it like a food label, so people can easily spot the topic of interest to them," says

Lisa Sotto, a partner at law firm Hunton & Williams, which helped develop a short form.

Patients would get these every time they go to the doctor for the first time or sign up for health insurance.

Expect the form to be widely adopted, since its sponsors include the VHA Health Foundation, which counts major hospitals among its members. *Arlene Weintraub*



DRAWN & QUARTERED



THE GRAPES OF EXPORT

VINO IS PULLING AHEAD OF VIN

WINE LOVERS IN THE U.S. ARE increasingly describing their favorite vintage as *molto buono*, instead of *très bon*.

Italian vineyards, which have been increasing market share in the U.S., have now surpassed the once-invincible French. Italian table-wine exports to the U.S. jumped 21%, to \$621 million, in the year that ended on June 30, beating France for the first time. U.S. sales of Italian varietal pinot grigio have doubled in three years, to 6 million cases, challenging the primacy of chardonnay. "Italians have spent the last decade re-inventing themselves," says

Rich Cartiere, publisher of the Calistoga (Calif.)-based *Wine Market Report*. "We are at the leading edge of big [export] wave."

Even Italy's southern regions, known for cheap wine, are going upscale. Sicily's L'Azienda Agricola Spadara vineyard will soon have its wines going for \$66 a bottle at Alain Ducasse's eponymous New York restaurant.

U.S. vintners such as Robert Mondavi and Kendall-Jackson, trying to take advantage of the boom, are buying vineyards in Tuscany. But the Italians are unlikely to yield easily. Says winemaker Franco Spadara: "Competition forces us to make better wines." Wine lovers are raising their glasses in agreement. *Gail Edmonds*



THE BIG PICTURE

WHERE ARE THE WOMEN CEOs?

Boys are far more likely than girls to choose "business" as their first career choice. Overall, the most desired careers are:

PROFESSIONS INCLUDING MEDICINE, LAW, ACADEMIA

OTHER (PROFESSIONAL SPORTS, ENTERTAINMENT)

BUSINESS

SCIENCE AND ENGINEERING

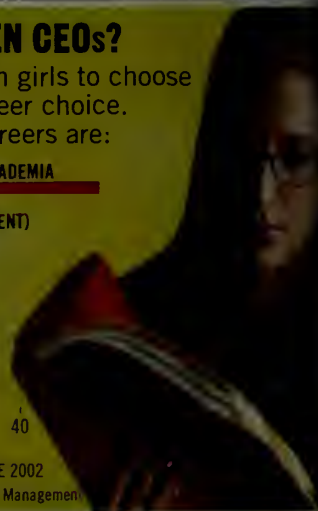
UNDECIDED

■ GIRLS ■ BOYS

► PERCENT

SURVEY OF 4,292 TEENS, GRADES 7-12, APRIL-JUNE 2002

Data: The Committee of 200/Simmons College School of Management



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THE MANY FACES OF PHILANTHROPY

Several modern-day philanthropists and the foundations they created shatter the stereotype of "cautious and unimaginative check-writing that dominated charitable giving for decades" ("The new face of philanthropy," Cover Story, Dec. 2). Starting in the 1960s, Silicon Valley pioneers David Packard and William Hewlett, through their family foundations, created and funded landmark conservation and environmental-protection programs, saving hundreds of thousands of acres of land from development.

The 1970s saw funding for hospice care, provided in part by New Yorker Arnold Louis van Ameringen through the van Ameringen Foundation, and the establishment of the 911 emergency number, thanks to grants from the Robert Wood Johnson Foundation and the generosity of the man who built Johnson & Johnson into the seventh-most-admired company in the world.

Sterling Speirn
San Mateo, Calif.

While philanthropy is praiseworthy in principle, your article could have looked more closely at how much of it really helps the poor. I suspect that many of the education, arts, and culture gifts are to elite institutions that service the upper class from which the philanthropists come and help to cement their social ties.

Sandy Weill's back-scratching donation to New York's 92nd Street Y and Alberto Vilar's support of opera are probably more typical than Bill Gates's

efforts to improve health care in Third World countries.

Jay We
New Y

As one of the (presumably) few subscribers to both *BusinessWeek* and *Country* magazine, I disagree with J. Byrne's suggestion that Ruth Lilly's money would have been better spent elsewhere. He didn't argue that millions for art museums and symphonies would

misplaced—why poet
The success of other
ganizations' poetry pr
ects—Poetry in Moti
Poetry Month, and the
vorite Poem Project of
Academy of American
ets—shows that verse n
ters to people. *Poetry*
now sponsor innovat
programs of its own.

Caroline S. W

Los Ange

You left out two

America's most generous men: B. Stephen Girard in 1948 and Milton H. shey in the early 1900s founded schools for orphans who otherwise would have become burdens to the American taxpayer. Incidentally, I am one of the many Americans who owe their lives and livelihoods to Girard and Hershey.

Joseph Piase
Maple Shade, N

Many people suppose that Andrew Carnegie, who was responsible for actually doubling the number of public libraries in the U.S., also funded the operations. That is not the case. Individual communities were required to pledge a certain level of annual support. Many have continued to do so, and their libraries have grown with



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Readers Report

CORRECTIONS & CLARIFICATIONS

"An ache at Amgen?" (Science & Technology, Dec. 9) incorrectly stated that the Amgen drug Enbrel is derived in part from hamster proteins. Although Enbrel is grown in hamster cells, it is a fully human protein.

community. Sadly, many others, like their communities, have fallen on hard times and have either been shuttered or demolished. We should all thank those philanthropists who see that investment in public libraries is investment in the future, just as it has always been.

John Hempel
Braddock Hills, Pa.

Silicon Valley could use a few more generous souls. There are great needs for shelter and basic provisions that are heightened by the economic downturn here. With any luck, a few of these philanthropic people will also help others a bit closer to home.

Mary Perkins
Atherton, Calif.

When asked about Barbara Cox Anthony's philanthropy, we said that she donates roughly half of her income to charitable causes. The \$9.5 billion net-worth figure you use does not represent the amount available for Mrs. Anthony to donate. It reflects a portion of the value of Cox Enterprises Inc., a private company that is held by several trusts of which Mrs. Anthony is one of the beneficiaries. Mrs. Anthony donates three ways: privately, through a personal foundation, and through the James M. Cox Foundation. She prefers to make contributions quietly, often anonymously, and wishes that her overall level of charitable giving remain private.

Your estimate of her total giving, \$40 million, is grossly understated. You noted only that she "adds just \$500,000 annually to her own foundation." While others were credited as being "private" philanthropists, Mrs. Anthony was not. Mrs. Anthony is a generous benefactor. Any suggestion to the contrary does her good works a great disservice.

Brian Farley
Corporate Communications
Cox Enterprises Inc.
Atlanta

IN DEFENSE OF WHARTON'S MIKE USEEM

I would like to clarify several statements made in "Rebuilding trust in

Tyco" (People, Nov. 25). First, I did participate in a boot camp for neophyte CEOs organized by former Tyco International Ltd. CEO L. Dennis Kozlowski. Second, the article includes a statement—from a person who admittedly never met me and who knew nothing about me—suggesting I was close to Tyco. In fact, my only contact with Kozlowski and his company came in an interview more than 10 years ago before he became CEO. Third, the article's title is: "Wharton's Mike Useem aims to overhaul the management culture at Tyco." In truth, my assignment from Tyco's new CEO is not to overhaul anything. It is only to advise him on corporate governance.

Finally, the article states: "On governance matters, Useem is an iconoclast, having staked out positions that set him at odds with his peers." The evidence offers is that "Useem advocates weaving ethics into the fabric of the company" and "He suggests focusing on integrity as much on business acumen when recruiting directors and making rigorous compliance with ethical standards a condition for promotion." I doubt whether many of my academic peers would be "at odds" with such notions.

Michael Useem
Professor of Management
Wharton School
University of Pennsylvania
Philadelphia

"Rebuilding trust in Tyco" is gratuitously critical of Michael Useem who is missing the real villains: the business press. Useem's experiential approach to leadership training is far from "useless" as your unnamed critics assert, but rather, represents the most successful leadership development and educational methods, including those practiced by the U.S. military in their learning-by-doing and after-action reviews. "Unconventional thinking" is exactly what is needed if we are to get superior results.

I know of few business executives or corporate directors who believe that Sarbanes-Oxley is anything other than a full employment act for corporate lawyers. Useem's insight on the importance of culture is exactly correct—formal procedures will inevitably be ineffective because, as even Arthur Andersen recognizes, in a culture of fraud and corruption, it will be impossible to catch or find anything.

If I had a dollar for every business journalist who heaped praise on Enron Corp. (or Tyco, for that matter), I could retire. The business press has been a major culprit in creating a culture ve-

Free
me.

Power
me.

Best of
both worlds
me.

ing the celebrity CEO, has more of-
promoted rather than questioned
ous fads, and has been amazingly
tical of its role in promoting the
uit of (often temporary) stock-price
imization that is one of the causes of
of the current financial scandals.

Jeffrey Pfeffer
Graduate School of Business
Stanford University
Stanford, Calif.

BOEING PROMOTES INNOVATION

"The battle over a radical new plane"
ence & Technology, Nov. 25) pro-
s a distorted view of Boeing Co.'s
ts to evaluate new technologies and
g new commercial airplanes to mar-
Our employees and our culture
note innovation and new ideas, fund
oration of alternative concepts, and
nologies, and encourage internal de-
and discussion.

through 10-for-10 successful product
ches, we have dramatically changed
landscape of the industry and im-
ed the public's ability to travel safe-
onveniently, and economically. And
will continue to do so. Our success
be determined by the value we cre-
for our customers, employees, com-
munities, and shareholders.

Alan Mulally
President and CEO
Commercial Airplanes
Boeing Co.
Seattle

AT WOMEN GAINED SALOMON SMITH BARNEY

is legal counsel to the class repre-
atives who filed the lawsuit against
mon Smith Barney, helped negotiate
settlement, and participated in the
tive and effective process outlined in
settlement agreement, we wish to
and on some of the information con-
ed in the book review of *Tales From
Boom-Boom Room* ("Sex and the
et," Books, Nov. 25).

as part of the class action settlement,
omon Smith Barney has allocated
million to implement a diversity
gram to hire and retain qualified
men and minorities as brokers, ana-
s, and investment bankers; linked
nagers' compensation to women's suc-
at the firm; dramatically increased
percentage of female branch man-
ers, brokers, and broker trainees; and
put all employees on notice that the
would not tolerate sexual harass-
nt. More than 1,800 claims have been

settled of the 1,950 filed, involving sub-
stantial sums of money.

While there is still plenty of room
for improvement at Salomon Smith
Barney and in the rest of the securities
industry, this landmark settlement has
been followed by profound progress for
thousands of women working in the
brokerage industry. In fact, other Wall
Street firms have eliminated mandato-
ry arbitration as a condition of em-
ployment, benefiting women and mi-
norities with discrimination claims. The
NASD and the New York Stock Ex-
change have eliminated the mandatory
arbitration requirement from their reg-
istration forms, a major victory, con-
sidering that the Supreme Court has
consistently upheld the practice of man-
datory arbitration.

Mary Stowell
Linda Friedman
Stowell & Friedman Ltd.
Chicago

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SCOTTY

James B. Reston and the Rise and Fall of American Journalism

By John F. Stacks

Little, Brown • 373pp • \$29.95

THE SEDUCTION OF SCOTTY RESTON

Power, as Henry Kissinger once famously suggested, may be an aphrodisiac. But for journalists, especially in Washington, mere access to power is headier stuff still. Having top officials trust you enough to confide secrets is an intoxicating but dangerous brew. In the news biz, what separates the great ones from the hacks is an ability to disengage from what can be very personal transactions, probe rather than parrot what the powerful tell you, and then speak the truth as you see it. And the hardest part is doing this in such a way that the powerful will still talk to you after your story comes out.

A rare and rich exploration of this encounter between journalism and power can be found in *Scotty: James B. Reston and the Rise and Fall of American Journalism* by John F. Stacks. The absorbing, first-rate biography of one of the 20th century's greatest journalists has a provocative thesis: As a correspondent and later Washington bureau chief for *The New York Times*, the legendary Reston walked the line more skillfully than anyone before or since—and yet it was “so difficult that in the end even Scotty Reston could not sustain it.” In fact, as Stacks shows, it's shocking how hard he fell.

Stacks, a veteran *Time* magazine editor, knows this world and writes about it with aplomb. Blessed with the cooperation of the Reston family (Scotty died in 1995), Stacks has also checked everything with multiple sources. The resulting portrait acknowledges Reston's greatness without glossing over his ultimate seduction. Readers witness pivotal events stretching from World War II through Watergate as Reston, with his extraordinary contacts, viewed them. The volume will captivate anyone with an interest in politics, public policy, and the strange ways of the Fourth Estate.

The son of pious, poor Scottish immigrants, Reston first made his mark as the captain of the University of Illinois golf team and, later, in the public-relations office of the Cincinnati Reds baseball team. How he became the most powerful journalist of his era is an American success story: He was talented, yes—but Reston was also indefatigable in cultivating useful friends and playing office politics.

Reston's greatest gift, Stacks believes, was “his understanding of how to use what he learned.” Not only did the journalist have extraordinary entrée to history in the making, but “he understood its importance, he conveyed it to his readers, and he protected his future access to the most powerful.”

Reliving this career is like visiting a garden of lost treasures. From Dwight D. Eisenhower to Lyndon B. Johnson, Presidents thought nothing of picking up the phone and spilling their guts to Reston. His power didn't always come from reporting what he knew. Sometimes it was the result of withholding information. Stacks combs out the extraordinary roles Reston played in deciding what the public would learn during the Cuban Missile Crisis, the Bay of Pigs fiasco, and the bombing of Hanoi.

Reston became not just famous but rich as well. *The New York Times* provided him with a huge salary, a car, even the company jet. Yet Reston, a trusting soul who believed in the goodness of American ideals and institutions, became so wrapped up in his role as Father Confessor to the Powerful that he lost the ability to make critical news judgments. For example, Stacks describes how, a year after Reston bought a small community newspaper on

Martha's Vineyard as a plaything was among the first to learn that a driven by Senator Edward Kennedy had plunged into the water off a Chappaquiddick bridge. Reston phoned story in to the *Times* with the le “Tragedy has again struck the Kennedy family,” not mentioning victim Mary Kopechne until the fourth paragraph. The story had to be rewritten.

The next day, Reston and *Times* reporter Joseph Lelyveld went to scene, where they found the two who had discovered the car and who had called the police. “Lelyveld took notes,” says the author, while Reston who felt this was a soon-to-be forgotten incident, “took a fishing rod out of the car and began fishing with the boy.”

Lelyveld reflected later: “I had no sense of how people outside of Washington would see the story.”

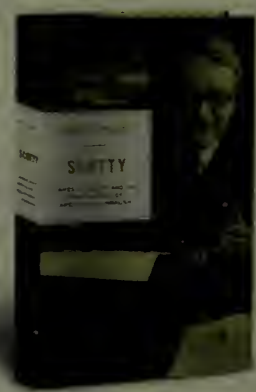
But Stacks saves his harshest criticism for Reston's sycophantic relationship with Kissinger, the only official in the paranoid Nixon Administration who would talk to him. Kissinger wrapped Reston around his finger, going so far as to ask him to serve as a deliverer

boy. During an interview with Fidel Castro, Reston once paused to declare, “I'd like to put on my diplomatic hat because I have a message for you from the Secretary of State, Henry Kissinger. He wants to begin negotiations to normalize relations.”

Stacks's message in all this for modern-day journalism? Not what you might think. He notes that Reston ultimately became too close to those in power. Even “his core notion that those in government, more often than not, were trying to do the right thing for the United States of America” might serve us better after September 11 than the “corrosively reciprocal cynicism” that has come to characterize press-government relations. Sad to say, Stacks sees few signs that things are changing. A good starting point might be to have both press and government officials read this engrossing and thoughtful volume.

BY DOUGLAS HARBRECHT

Harbrecht's 24-year career in Washington includes covering the White House and Congress.

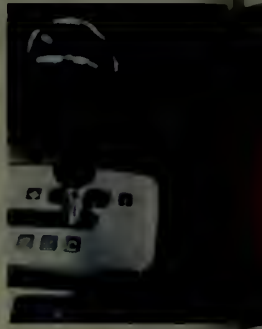
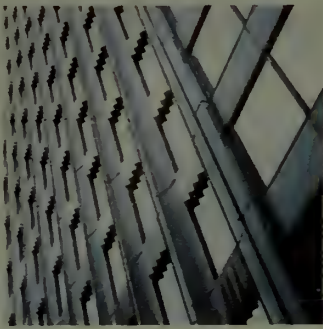


ULTIMATELY, RESTON WAS UNDONE BY HIS ROLE AS FATHER CONFESSOR TO THE POWERFUL

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When you sing to the radio

When you have a backup route

When you use the time to prepare for work

When you use the time to forget about work

When you feel part of something larger

And rush hour passes in minutes

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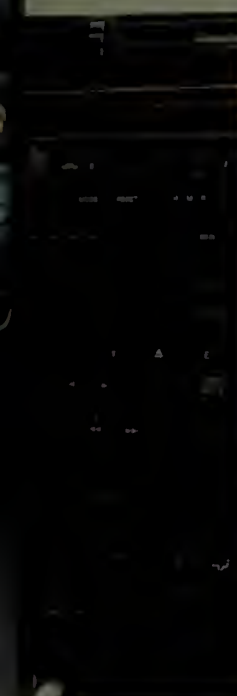
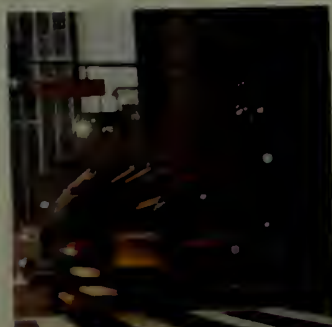
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BY STEPHEN H. WILDSTROM

tech&you@businessweek.com

THE UPPER HAND IN HANDHELDS?



With its new Axim X5, Dell is out to undersell competitors—and still make money

Dell Computer's pattern of attack is familiar by now: Find a product that enjoys good margins. Then build it—or have it built—cheaply enough so that you can underprice the competition and still be profitable. Ship the product, and watch the market-share points stack up.

Handhelds are the latest target in Dell's search-and-destroy mission against fat margins. Dell took a hungry look at Hewlett-Packard's iPAQ, which dominated the market for handhelds running Microsoft's Pocket PC software despite prices generally north of \$500. Working with Wistron Group (owned mostly by Taiwan's Acer), Dell developed the Axim X5 and offered it at the unprecedented price of \$199, after a \$50 rebate.

The Axim is a typical Dell product: a solid but not trendsetting design, packed with features—and a remarkable value. Nearly ¾-in. thick and weighing almost 7 oz., it's a bit on the chunky side, especially for users with small hands. But inset rubber strips on both sides make it easy to grip, and a jog lever on the left side makes it convenient to scroll through lists and select items using one hand.

Battery life is difficult to measure in handhelds because usage patterns vary so much, but the Axim's big battery should get most people through at least a couple days of work. The battery is removable, so carrying a spare (\$59) on a trip is a nice alternative to traveling with the charger. The less expensive of two models comes only with a charger and sync cable, but the \$299 premium version features a cradle that can charge both the unit and an extra battery at the same time.

The Axim has no built-in wireless communications. However, it features both a CompactFlash slot that can be used for a variety of wired and wireless communications options and a slot for postage-stamp-size SD memory cards.

This product is not the first low-priced challenger in the Pocket PC market. Viewsonic recently introduced its Pocket PC V35 at \$299.

Nevertheless, Dell's marketing clout and its footprint in big corporations changes the equation dramatically.

Dell's plans for a low-cost Pocket PC were open secret for months before the Nov. 18 announcement, and HP didn't take the development lying down. It has countered with the stylish, 4.5-oz. iPAQ h1910, the thinnest and lightest Pocket PC ever and, at \$299, one of the cheapest.

The h1910 is designed for people who want a Pocket PC that actually can slip easily into a pocket but that does not offer a lot of options or accessories. Its single SD slot is usable only for memory. And although it uses the same sync and power connector as recent Compaq iPAQs, it lacks the connector that allowed the older models to slide into "sleeves," enabling them to function as cell phones, global positioning receivers, and other types of devices.

Like the Axim, the h1910 has a removable battery and an extra charger slot for the sync cradle.

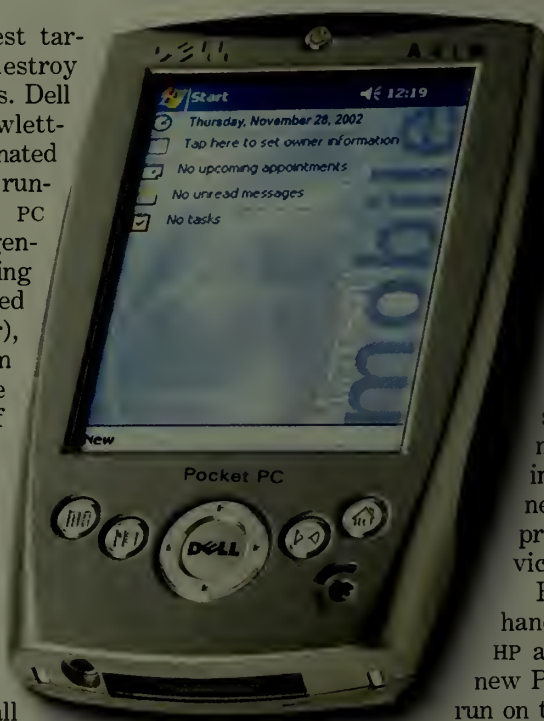
HP is not abandoning the high end of the handheld market. It is also offering the \$699 iPAQ h5440, about the same size as the Axim, it includes built-in WiFi wireless networking and Bluetooth short-range wireless communications. It also has an integrated fingerprint scanner that can limit access to programs or data to the device's owner.

For its initial thrust into handhelds, Dell is going after HP and the Pocket PC. But its new Palm operating software can run on the same hardware as Pocket PCs with fairly minor modifications.

and Dell may do a Palm version in the future. While much bulkier than the \$499 Palm Tungsten T (BW-Dec. 9), the Axim boasts a faster processor and more memory at a much lower price.

I have no doubt that Dell's entry into handhelds will have the same effect as its presence in desktops, laptops, and servers: It will drive down prices across the board. So far, this has been a very good thing for consumers and corporate buyers. But I do have one reservation: Dell's product development has, in effect, stood on the shoulders of research-minded competitors such as HP and IBM, whose ability to fund research has been hurt by the relentless squeeze on margins.

As Dell's dominance grows, the industry's ability to innovate may depend on the company's willingness to go beyond its current minimal research and development spending. Designing the first handheld that could function as either a Palm or a Pocket PC would be an interesting place to start.



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BY ROBERT KUTTNER

IN WHOSE POCKET WILL STIMULUS LAND?



WINDFALL:
The real
debate
is over
who will
benefit
—the rich,
the poor,
or the
middle class

Robert Kuttner is co-editor of *The American Prospect* and author of *Everything for Sale*.

In coming weeks, both political parties will engage in a lot of posturing about what kind of economic stimulus the flagging economy needs. An economic slump, by definition, is too little demand chasing too much capacity. So if we want to stimulate the economy, we need to put more money in consumers' pockets. These consumers, of course, can be middle-class, poor, or rich. We can also stimulate the economy by increasing public spending. In terms of macroeconomic impact, it doesn't much matter which consumers get the breaks, only that the money enters the stream of commerce.

So the real debate here is less about stimulus than about who benefits. Do we bestow tax cuts on working families or investors? Do we boost public spending by helping fiscally strapped states and cities? Or shelve that spending in favor of more tax cuts?

The White House stimulus package that will probably be announced in January will be mostly—what else?—tax cuts tilted to the upper brackets. These could include a speeding up of personal income tax reductions under the 2001 tax cut, as well as corporate tax breaks. Top candidates are relief from “double taxation” of dividends and reductions in the corporate income tax, supposedly as investment incentives.

As economic stimulus, the case for investment incentives is weak. The economy is awash in excess capacity. The accelerated depreciation breaks in last January's alleged stimulus package did little to boost investment because people don't invest when they see overcapacity. The case for relief of double taxation is even weaker. For starters, there's no double taxation of more than half of corporate dividends because they go to tax-exempt institutions such as pension funds. And a lot of corporate earnings escape initial taxation because of breaks already on the books.

Even the Business Roundtable is more enthusiastic about stimulating demand, via payroll-tax relief, than more tax breaks for business. Outgoing Treasury Secretary Paul H. O'Neill was dismissed partly for his incautious dissent from the Administration's obsession with tax cuts. Oddly enough, his successor John Snow has expressed similar views.

Most GOP politicians favor tax cuts in all economic seasons—when the budget is in deficit and when it is in surplus, in booms and in busts. Tax cuts slash revenues and constrain the size of government. This is their principled reason. But Republicans also use tax cuts to reward business allies, which has nothing to do with principles.

“Stimulus” is merely the rationale du jour.

Historically, Democrats have contended that a downturn, tax relief for low- and middle-income consumers yields more economic stimulus because these groups go out and spend the money. In principle, this view offers Democrats a chance to draw a contrast with the GOP program.

However, unlike Republicans, who are most unified on both its tax program and underlying philosophy, Democrats are split three ways. The balanced-budget faction, including Senator Kent Conrad of North Dakota, outgoing chair of the Budget Committee, and Presidential aspirant Senator John Edwards of North Carolina, considers the Republican program fiscally irresponsible and resists tax-cutting or spending.

A second contingent, which includes the House and Senate Democratic leadership, has criticized the Bush tax cut but has been too intimidated by Bush's popularity to demand its repeal. This also leaves Democrats little running room for spending programs or worker tax relief.

The Democrats' election debacle, however, has shifted momentum to a third group, which challenges the Republican program frontally. Massachusetts Senator John F. Kerry declared in his first speech as a prospective candidate for President that most of the 2001 tax cut for the wealthy should be shelved in favor of immediate payroll-tax relief to put money in the pockets of ordinary wage earners (and make it cheaper for business to create jobs). Kerry also proposed extended unemployment benefits and targeted investment and dividend breaks. Other pro-spending Democrats are working on a program of fiscal relief for states. This mostly demand-side approach could appeal to more voters as well as provide more targeted stimulus.

Confusing arguments over values with arguments over technical policy choices is an old story. Under President John F. Kennedy, chief economic adviser Walter Heller sparred with kitchen-cabinet kibitzer John Kenneth Galbraith over the best kind of fiscal stimulus—tax cuts or public spending (Heller won, and taxes were cut). But their real argument was about the need for increased social outlay and the size of government. Likewise under Ronald Reagan, deficit spending through tax cuts was dressed up as supply-side economics, but the deeper goal was to shrink the public sector by starving it.

Politics is about choices. Politicians should admit that in an economic downturn, one dollar of deficit spending is roughly as good as another—and start debating the real issues.

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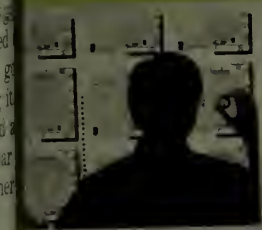
The reality is you'll find more Scots donning lab coats than kilts these days. In electronic design, our innovative Alba Centre is leading the world's R&D in System Level Integration technology, as well as promoting enormously successful collaborations between top universities and private sector partners. And of course, there's Dolly, now famous sheep who became the first mammal cloned from an adult cell—a direct result of Scotland's thriving and inventive tech industry.

Today, the question progressive companies are asking us has little to do with matters such as why we wear kilts—and has everything to do with how to gain access to the kind of vast knowledge base Scotland offers.

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JAMES C. COOPER & KATHLEEN MADIGAN

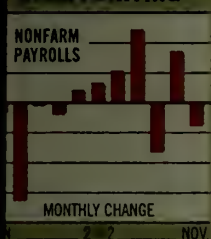
WHY CUTTING UNEMPLOYMENT WILL BE ONE TOUGH JOB

Companies are giving raises as productivity improves, but few are hiring

U.S. ECONOMY

Forty thousand workers had a dismal start to the holiday season when their employers cut their jobs in November. Last month's increase in the unemployment rate to 6% ensured that 2002 will see the highest jobless rate since 1995. Will labor markets improve in 2003?

WHY WILL REMAIN STAGNANT



Source: Bureau of Labor Statistics, Global Insight Inc.

The question's importance extends beyond those looking for work or hoping to switch jobs. Consumer spending, the main engine of the recovery so far, will depend more on income growth in 2003 because households won't be able to tap other resources as they have this year. Given the recovery and the growing federal deficit, bond yields have

bottomed out, meaning fewer mortgage refinancings. And any tax cuts passed next year will probably target businesses, and not consumers who reaped a buying power from the 2001 rebates and 2002 rate reductions.

The job markets are also on the mind of Treasury Secretary nominee John W. Snow (page 30). At his first press conference on Dec. 9, Snow said the Administration "cannot be satisfied until everyone—every person who is unemployed and seeking a job—has an opportunity to work."

But the Secretary-to-be will face an unusual labor market next year. Given the paralysis among businesses, along with the continued pressure to boost profits, companies will remain reluctant to add much to payrolls (chart). At the same time, though, they will be expected to boost the pay and benefits of their existing employees because those workers have the expertise to improve productivity on the rise.

As a result, job growth early next year will probably average less than 100,000 a month, and the jobless rate will be slow to decline significantly. But real after-tax incomes should grow by about 3% next year, paving the way for steady gains in consumer spending.

NOVEMBER EMPLOYMENT REPORT

while disappointing, needs to be put in perspective. Total payrolls were higher last month than in April. Job losses remained concentrated in the slumping manufacturing sector; private-sector service companies in November

added workers for the ninth straight month. And by historical standards, the 6% jobless rate is actually quite low at this stage of a recovery. A year after the 1990-91 recession, it was 7.4% and headed higher. After the 1981-82 downturn, it was a painful 8.5%. Moreover, the current readings on jobless claims suggest the rate will begin to fall at the start of 2003. In early December, the four-week moving average of claims, which eliminates the data's week-to-week jumpiness, is at the lowest level since the recession began (chart).

However, as Snow pointed out, any excess unemployment is undesirable, and a jobless rate hovering around 6% is high, given that real gross domestic product is growing at a 3.2% yearly rate. Back in 1994, the last time unemployment was 6%, real GDP was expanding by 4.1%. That suggests the economy can grow faster and more people can be put to work without any fear of price pressures down the road.

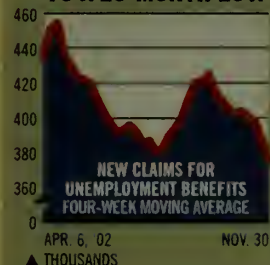
The lack of inflationary worries is the key to why the Federal Reserve will be able to keep interest rates very low next year. As expected, the Fed took no action at its Dec. 10 meeting. Policymakers kept the federal funds rate target at 1.25%. In the accompanying statement, the Fed said the risks for the economy were balanced between inflationary pressures and weaker economic growth. The Fed also noted that the latest available data, "taken together, are not inconsistent with the economy working its way through its current soft spot."

MORE BUSINESSES ALSO EXPECT brighter days ahead. The Institute for Supply Management released its semiannual survey of business expectations among its members. According to the report, 70% of manufacturers and service companies think their sales will be higher in 2003 than they were in 2002.

The ISM also said that manufacturers expect their capital expenditures to rise by an average of 4.6% next year, with service companies holding their capital budgets about flat. That's far from a boom, but keep in mind that factories and service companies will have cut this year's outlays by 6% and 2.6%, respectively.

But the outlook on jobs is cautious. Manufacturers

JOBLESS CLAIMS FALL TO A 20-MONTH LOW



Source: Global Insight Inc., BusinessWeek

Business Outlook

see payrolls falling 0.6% next year, while the bigger service sector expects only a 0.2% gain. However, modest job growth and a jobless rate stuck between 5.5% and 6% does not mean wages will not rise next year. In fact, one of the twists in today's economic environment is that businesses may not be in the mood to hire, but they will be willing to pay their workers more in exchange for robust productivity gains.

GONE ARE THE DAYS of the late 1990s, when some employees enjoyed perks like dog walkers and huge signing bonuses. However, a survey of 852 midsize companies done by human resource company Compensation Resources Inc. found that companies will give bigger pay raises in 2003 to almost all employees. The exception is production workers, whose expected increase of 3.5% is a tad below 2002's 3.6% raise.

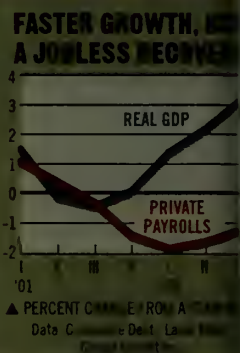
The survey also found that 43% of companies plan to give bonuses equal to or larger than the 2002 payouts. Those results match a similar report on big companies by the Conference Board, which noted that "most workers will still come out ahead of inflation," leading to future gains in consumer spending.

Companies will also pay more next year for their employees' health insurance. Mercer Human Resource Consulting LLC says businesses expect insurance costs to rise 14%. That's after medical coverage jumped almost 15% this year, to \$5,646 per employee.

Of course, businesses need productivity increase to cover these higher compensation costs. This exchange was already evident this year. Hourly compensation rose 3.3% in the year ended in the third quarter, output per hour worked jumped by 5.6%, so the cost of labor to produce each unit of output fell 2.2%. That's why profit margins in the third quarter were higher than they were a year earlier.

Expect that trend to narrow somewhat in 2003. But even if productivity is cut in half, that pace allows plenty of room to generate modest gains in both real wages for workers and profit margins for businesses, even if pricing power is weak. However, prices in the earlier stages of production are already firming up, and in the profits outlook, a little bit of pricing power goes a long way.

The bad news for job seekers is that productivity gains allow businesses to boost output without adding as many workers (chart). Executives will have to reassert their confidence in the future before they begin hiring at a pace strong enough to significantly lower the jobless rate. And an improving profits outlook is one critical part needed to restore that optimism.



BRITAIN

THE BANK OF ENGLAND NAVIGATES A SPLIT ECONOMY

The Bank of England kept interest rates steady on Dec. 5, even after the Federal Reserve and European Central Bank cut their target rates. The hold-tight stance of the BOE shows the finesse needed to manage a slow-fast split economy.

British real gross domestic product grew at a 0.8% quarterly rate in the third quarter, or by 1.8% from a year ago. Fast-spending consumers accounted for most of the growth. Their real purchases rose 0.9% last quarter and 3.7% over the past year.

Consumer spending is being buoyed by strong labor markets. The jobless rate remained at a 27-year low of 3.1% in October, and

salaries are up by 3% in the past year. Finances are also getting a boost from home values, which in November jumped by 29% over the past year, according to a major British mortgage lender.

FACTORY OUTPUT IS STILL CONTRACTING



0.7% this quarter.

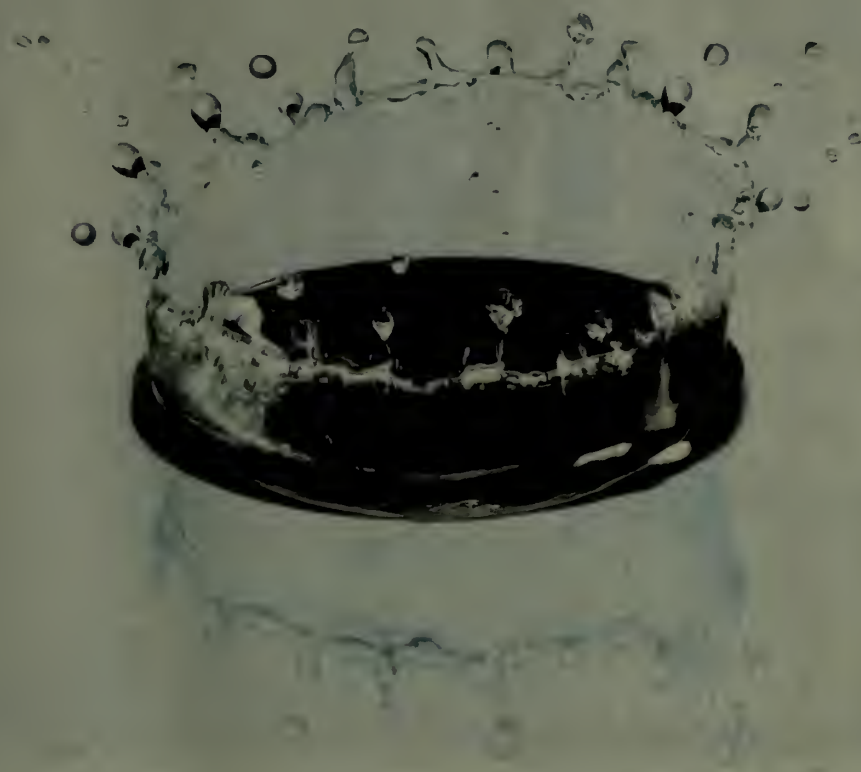
Mervyn King, set to become the BOE governor in June, 2003, has expressed concern about the housing market. If prices collapse, Britain could fall into recession.

Consumers are tapping into this rapid buildup of wealth. Home equity loans rose by 10.6 billion pounds (\$15.9 billion) in the second quarter, according to BOE data. The uptrend in borrowing is one reason real GDP is expected to rise an additional

Conversely, if home prices continue to surge, consumer inflation, already at 2.1%, could worsen.

In the meantime, manufacturing remains the slow side of the economy, in part because of falling exports to the U.S. and the euro zone. October industrial production was down 1.2% from a year ago. The November purchasing managers' index weakened. And pricing power is nil among industrial companies. Producer prices fell 0.2% in November, after no change in October.

The economy's split has the BOE in a bind because a rate cut designed to help out manufacturing would also lower mortgage rates and boost home prices further. For now, analysts are expecting that inflation fears will win out and that the BOE will hike rates sometime in the first half of 2003.



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TODAY

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NEW
TEAM

THE BATTLE OVER TAXES



The shake-up of the President's economic team has stoked an already fierce debate over tax cuts vs. deficits

If George W. Bush thought he'd be basking in universal applause for shaking up his underperforming economic team, he guessed wrong. While business execs heaved a sigh of relief on Dec. 6, when the President fired Treasury Secretary Paul H. O'Neill and White House economist Lawrence B. Lindsey, Bush's plans for a seamless succession haven't panned out.

Just days after the purge, the White House tapped CSX Corp. CEO John W. Snow for the Treasury job (page 32), named retired Wall Street exec William H. Donaldson to head the Securities & Exchange Commission (page 33), and was expected as early as Dec. 12 to sign up Stephen Friedman, ex-COO of Goldman, Sachs & Co., to run the National Economic Council. The result: fu-

rious criticism from the Right over Friedman's deficit-phobia and a renewed debate—likely to intensify next year—over whether Bush's tax cuts will bust the budget.

While conservatives swallowed their misgivings about Snow, whom many privately deride as a traditional corporat, White House political aides had to spend several days phoning right-wing activists to quell rebellion over Friedman. Conservatives' beef with the 63-year-old financier, who ran Goldman with Robert E. Rubin prior to his friend's departure to serve as Bill Clinton's Treasury Secretary, is that he is a Rubin clone. Because Friedman, like Rubin, believes deficits are harmful, they fear he won't effectively sell a tax-centric economic policy. Says David A. Keene, president of the American Conservative Union: "Why don't we

just bring Rubin back instead of a p imitation?"

In a sense, Friedman has become a symbol of a much larger fight, one with roots in the Ronald Reagan era: Should the government spur economic growth with cuts in marginal tax rates and generous business-tax incentives, or should the focus be on eliminating a deficit that puts upward pressure on interest rates?

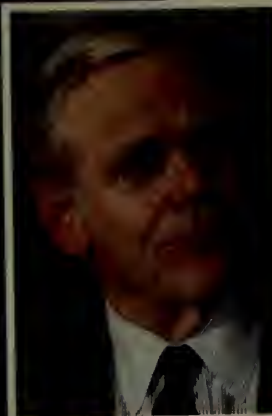
Each side can cite anecdotal evidence, but nothing conclusive, to support its views. In 1993, when Rubin helped steer Clinton away from a big social-spending program into tax hikes and deficit-cutting, supply-siders predicted an economic collapse. Instead, the economy boomed. Now, the debate has flipped. Deficit hawks, led by Rubin and traditional Republicans, such as Peter G. Peterson, president of the Concord Coalition and chairman of investment firm Blackstone Group LP, warn that Bush's big tax cuts will swell the

HARD
SELL

The
challenge
facing
Bush's
new
economic
team



AS TREASURY SECRETARY, SNOW (FAR LEFT) WILL HAVE TO WORK WITH THE GAME PLAN OF POLITICAL STRATEGIST KARL ROVE



CAN DONALDSON'S SEC RESTORE FAITH IN THE MARKETS?



RIGHT-WINGERS DERIDE FRIEDMAN'S DISLIKE OF DEFICITS

demanding loyalty to Bush's philosophy. That means Treasury honcho Snow, who sounded ultratraditional during the 2000 campaign, will have to change his tune. That year, he told *BusinessWeek* that Job No.1 for Bush was to "secure the surplus... and use a significant part of it to pay down the debt."

That won't happen now. Instead, economists say, the short-term deficit will rise as high as \$250 billion. That means Bush has to hope that the stimulative kick of aggressive tax cuts will rocket growth up to 3.5% to 4%. That would render the deficit a fairly small share of gross domestic product.

The Bush crew's insistence that tax cuts will cause output to spurt isn't rooted solely in GOP evangelism. It also reflects the backstage policy power of

White House über-strategist Karl Rove. He is willing to roll the fiscal

dice in the short term in hopes of restoring market confidence, providing a bigger fiscal jolt for the slumbering economy—and providing "election insurance" for his boss by saving significant stimulus for 2004. "There's no doubt what Karl is focused on," says an Administration official.

Indeed, Rove & Co. may opt to delay moving up the '06 cut until the election year, a step that would give families an income boost just as Bush is campaigning for a second term.

Another bit of '04 juice could come

it, push up interest rates, and eat ons of dollars needed for baby ners' retirement. So far, the hets of interest-rate Armageddon been just as wrong as supply- s were back in '93. Why? The econ- is weak, tech is pushing many es lower, and global overcapacity is ng to the disinflationary pressure. his debate will come to a boil in ary, when the President's new team out a jobs-and-growth package that eavily dependent on big tax cuts.

Bush will ask Congress to speed up some of the cuts enacted in 2001, make his tax-rate changes permanent, add new incentives for individual savings and investment, and grant a tax break for business purchases of capital equipment. The price tag: perhaps \$40 billion to \$50 billion in 2003 and up to \$300 billion over 10 years.

Despite questions over whether Bush's recruits will be enthusiastic advocates for more tax-cutting, the White House wouldn't sign up a new team without

RESTORE CONFIDENCE

will be calming jittery CEOs, investors, and fretful s in an effort to boost capital buttress the stock market, cash registers ringing.

SELL STIMULUS

Snow and his team will have to convince Congress and the public that another round of tax cuts will accomplish what earlier versions did not: getting the economy back in high gear.

WIN THE BOSS'S EAR

The old economic team was largely eclipsed by White House staff. The new crew, which is not chummy with Bush, needs to earn the President's trust if they are to influence policy.

LOOK TO THE LONG TERM

Self-described fiscal hawk, seems willing to let n deficits rise to boost the economy. But he'll need ce other fiscal conservatives that the White House e books back in balance in the long run.

FIX STRUCTURAL PROBLEMS

Bush remains enthusiastic about embarking on wholesale reforms of the tax code, Social Security, and Medicare. But Snow and his team will have to surmount huge political and financial hurdles to translate those hopes into reality.

from a plan to give investors relief from the "double tax" on corporate dividends. The Administration wouldn't eliminate the levy entirely but could opt to permit individual investors to exempt, say, 20% of their dividends from taxation. A policy that gradually eliminates double taxation is considered sound by many economists because it would end the revenue code's penalty on companies that pay dividends. But full elimination could cost a staggering \$250 billion over 10 years.

If partial relief from double taxation is enacted next year, it won't be felt by most taxpayers until April, 2004—just as they are preparing their 2003 returns. Says William C. Dudley, chief

economist at Goldman Sachs: "As far as Karl Rove is concerned, the fact that [tax relief] is coming through in the spring of '04 is not at all bad."

But the deferred-gratification strategy is risky. The Administration is gambling that the feel-good effects of the package will boost the stock market and ease corporate and consumer anxieties about the future right away. But there is reason to doubt that a small tax cut will have an electric effect on a \$10 trillion economy. According to a study by University of Michigan economists, only 22% of the families who got rebates of up to \$600 in 2001 actually spent them. And with unemployment hitting an

eight-year high of 6% in November, some worry that skittish consumers will finally trim spending, knocking Christmas sales down and setting the stage for a weak start to 2003.

That's why many Democrats—even some business groups—favor a payroll-tax cut next year. One proposal would give workers a six-month break from payroll taxes on Social Security and Medicare applied to the first \$10,000 of wages. That would quickly pump \$10 billion into the pockets of workers and might give the economy a rapid kick. The downside, aside from the high price tag: It could further undermine the Social Security Trust Fund. Democrats

COMMENTARY

By Bruce Nussbaum

HEY, ISN'T THERE A JOB FOR JERRY FORD?

The Bush Administration is looking like a blast from the past. With the appointment of John Snow as Treasury Secretary, just about the only person left who served in the Ford Administration who hasn't been appointed to the Bush White House is Gerald Ford himself. What's up?

First, it's clear that Vice-President Dick Cheney's Rolodex hasn't been updated in 30 years. Let's count the Ford cronies he has helped pick to help him run the country: Defense Secretary Donald Rumsfeld, of course; both ex-Treasury Secretary Paul O'Neill and his replacement, Snow; Henry Kissinger, who heads the new commission on September 11; and William Webster, who briefly ran the new accounting oversight board.

Sure, the new head of the Securities & Exchange Commission, William Donaldson, didn't serve under Ford. But he was Under Secretary of State to Henry Kissinger under President Nixon. And he one-ups his colleagues on the six-degrees-of-separation scale by starting his Wall Street career at G.H. Walker, founded by President Bush's grandfather. Donaldson attended Yale, was a classmate of Jonathan Bush, the Presi-

dent's uncle, and belonged to the Skull & Bones secret society, like the President and his father. Wow.

The other, and perhaps more important, defining characteristic of the people around President Bush is that they are all so Old Economy. Snow, the chairman and chief executive of CSX, is from the railroad industry, that high-tech engine of the 19th century. His predecessor, O'Neill, came from Big Aluminum (Alcoa Inc.). Cheney is from Big Construction (Halliburton Co.), and Commerce Secretary Donald Evans and the President are from the oil patch. Outgoing SEC Chairman Harvey Pitt represented Big Five accounting. Kissinger Associates Inc. opens doors for Big Business overseas.

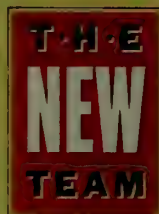
The President has said that he missed the political turmoil of the '60s when he was at Yale. O.K. But most of his advisers and administrators missed the New Economy turmoil of the '90s. And that may not be fine.

Why? The Bush Administration is made up mostly of people who made their bones in big, traditional industries where connections and clubby ties to government matter most. There are hardly any entrepreneurs or high-tech folks who succeeded in the wild and

wooly market capitalism of the '90s.

No doubt, Cheney, Snow, and I sincerely believe in deregulation, free markets. But let's face it, in defense, oil, and drug companies, industries that often depend on government contacts and contracts for success. It's no coincidence that the three largest armies of lobbyists are in those industries. Snow, for example, pushed transportation deregulation when he was in government, then became a road lobbyist, helping to write the bill for deregulation and finally becoming a big railroad company. In short, Bush people are mostly old guys in old-style industries who are using business the old-fashioned way, through their close circle of friends at the golf course or at the Business Roundtable and at quiet dinners with their pals in government.

So what if these Old Economy types dominate the Bush Administration while the New Economy types in



SO RETRO The Bush bunch mostly comprises men who made their mar

want to move up scheduled rate but only for the middle class. And freeze rate reductions for the high and limit tax breaks for very estates. They claim this approach stimulate the short-term economy but busting the long-term budget. Any of the Dems' plans focus on middle-class consumers. But the White House doesn't believe they're the economic main problem. Instead, it argues a lack of capital investment is the problem. That's why the President wants to expand first-year write-offs for purchases of plant and equipment by hiking them from 30% to around 50%. The idea is that cutting the aftertax costs of investments will get companies to turn out new gear. Two beneficiaries: the hit telecom and tech sectors.

But it's not clear that even these added breaks will stimulate investment by industries that are still saddled with massive overcapacity. Similar tax sweeteners enacted last March have done little so far. Martin Regalia, chief economist at the U.S. Chamber of Commerce, says they're good for the long haul. But "you're not going to get an economic-stimulus-type kick out of expensing."

Other elements of the Bush package are included less for their stimulative punch than as precursors to future reform of the tax code. A proposal to make it easier to contribute to tax-deferred 401(k) plans and individual retirement accounts would spur long-term savings. And in a political nod to the plight of the working poor, the White House may embrace a Capitol Hill-

backed proposal to make the child tax credit a bit more generous. What's more, to grease passage of any final package, the Administration may accept Democrats' pleas to extend unemployment benefits for jobless workers.

With Republicans in control of Congress, Bush and his team will have little trouble muscling their program past an outgunned band of Democratic liberals and a few lonely GOP deficit hawks. Then comes the ultimate test: Will this tax-driven fiscal fix help the weak economy and save Commander-in-Chief Bush from the family curse? Rove & Co. plan to leave very little to chance.

By Rich Miller, Howard Gleckman, and Lee Walczak, with Richard S. Dunham and Lorraine Woellert, in Washington

WHEN THEIR BOSS WAS A DIFFERENT PRESIDENT: CHENEY AND RUMSFELD IN 1975 (LEFT) AND KISSINGER, WITH GERALD FORD, IN 1974



part of a tax-reduction package—helping utilities, energy, industrial, financial, and materials companies that offer dividends, but not information technology companies that don't.

New Economy folks favor cutting capital-gains taxes to promote risk-taking investment over reducing dividend or even income taxes to promote demand in the Old.

It's easy to make too much of this split. Clearly, the Bush Administration is pro-business and wants to help the investor. It has the support of most CEOs, including many from high-tech companies. Moreover, ending the double taxation on dividends is likely a good

thing—it will help middle-class investors get a better return and curb the ability of CEOs to help themselves to company coffers. And it's easy to slide into ageism—70-year-old Rumsfeld ran a high-tech war in Afghanistan and is leading the battle to modernize the military.

But the sameness of the Bush bunch makes one wonder if it sees the business world through an Old Economy lens that distorts the New. To restore the confidence of the investor class and get the economy back on a high-growth path will require fresh ideas, new approaches, and surely a dose of imagination. So my question to the guys around Bush is simple: Can you Wi-Fi?

Nussbaum is the editorial page editor.

supply-side—whatever—agrees on cutting taxes, everyone is for deregulation. The big deal? The deal is the rise of a whole new kind of entrepreneurial capitalism based on a broad investor-financed innovation through market. It's the surge in pro-growth and the impact of information technologies. It's the new volatility to the business cycle, high unemployment, educated, white-collar professionals, the new role equity values in generating tax revenues for the government. That's the big deal. Around Bush, by and large, the '90s economic revolution and fear to get the implications for

policy. The result? The Bush Administration turns down a Silicon Valley suggestion that it invest money to wire every U.S. house with broadband and instead passes a \$182 billion bill to subsidize farmers. It raises tariffs on steel, textiles, and agriculture to protect Old Economy industries and angers countries who buy billions of U.S. high-tech gear. It backs the proposal to expense stock options to curb corrupt CEOs and threatens to take away the most important tool high-tech companies use to motivate their rank-and-file employees. It grudgingly acts to safeguard investor-class interests by blaming corporate corruption and Wall Street conflicts of interest on bad apples rather than systemic flaws. It makes ending double taxation of dividends a central

traditional companies where clubby ties to Big Government matter most

THE CABINET

THE TREASURY GETS A BIG-BUSINESS PRAGMATIST

John Snow likes balanced budgets—but he'll back tax cuts

Bouncing among academia, government, and business over the last 35 years, CSX Corp. Chairman and CEO John W. Snow has learned to make the most of every side of an issue. He has argued for shareholder rights even while moving against his own stockholders at rail giant CSX. And he espoused free-market principles while welcoming government-imposed limits on corporate

Is Snow, 63, up to the job? Friends say his ambition, smarts, and pragmatism will carry him through. Says John P. Clancey, chairman of Maersk Inc. and the former head of Sea-Land shipping, once a unit of CSX: "John is a team player, and John will do what the team wants done."

But don't try too hard to figure out what Snow stands for. A PhD in eco-

governance, in fact, helped Snow get Treasury job. But some shareholder activists fault Snow and his CSX board refusing this year to toss out a poison-antitakeover defense even though most shareholders approved a nonbinding resolution to do so. Shareholder advocate John Chevedden grouses that Snow "set himself up as a champion of good governance, but when it comes to performance on his part, he falls short."

Critics also fault his hefty pay at CSX where he has been CEO since 1989. Snow has collected at least \$25 million in cash and stock in the last four years, even as earnings proved erratic amid the troublesome integration of Conrail. And in 2000, the company forgave a stock loan valued at \$4 million. Shareholders watched their stock skid from more than

\$53 in early 1999

to about \$28 now.

At the same time,

Snow served on

the Conference Board

task force, where

he called for better

measures to link executive

pay to corporate performance.

Still, backers say

he'll be an ideal

liaison between the

White House and

Corporate America.

Snow has moved

easily in government

circles ever since

he joined President

Richard M. Nixon's

Transportation Dept.

as an assistant general

counsel. He went



ALL ABOARD: SNOW WORKED WITH A RIVAL ON A CONRAIL DEAL

takeovers. "He's not doctrinaire," says longtime colleague John C. Bogle, founder of mutual-fund outfit Vanguard Group Inc. "John is a pragmatic guy, and you don't have to be a genius to know the President is your boss."

As Paul H. O'Neill found out the hard way, Bush demands results. And Snow has been named to take over the Treasury at a critical juncture. With debate on how to get the economy humming heating up in Washington, Snow, who has spent years lobbying for balanced federal budgets, must get squarely behind Bush's program of tax cuts. Just as crucial, Snow will have to work hard to rebuild bridges between the Administration and Wall Street after a severely strained year, even though he lacks strong ties to the financial community.

nomics, Snow has shown he'll quickly toss aside economic theory when it gets in the way of his business interests. In 1996, he invoked a Pennsylvania anti-takeover law that let him shut out a higher bidder when he tried to buy up all of Conrail Inc. for CSX. "He has principles. He has views," says Linda Morgan, a Democrat on the Surface Transportation Board when it O.K.'d the Conrail deal. "But he also understands that you have to advance the ball."

To some, of course, such agility has the whiff of putting self-interest ahead of all else. In the wake of recent scandals, Snow co-chaired a Conference Board commission urging corporate directors to discourage "excessive" use of stock options, make such pay more performance-based, and advance shareholder rights. His work on corporate

JOHN W. SNOW

STRENGTHS A team player. His consensus-building skills should help Bush sell his tax plan on Capitol Hill.

POTENTIAL PROBLEM He'll need to abandon his well-documented stand against budget deficits to support the President's stimulus policies.

BIGGEST CHALLENGE Restoring investor confidence in the financial markets and rebuilding bridges to Wall Street.

BAGGAGE A spotty record on corporate governance. And although Snow recently co-chaired a task force deriding excessive pay, he has received \$25 million in cash and stock since 1999, even as CSX's shares tumbled 47%.

on to become administrator of the National Highway Traffic Safety Administration under President Gerald Ford.

Snow is wasting little time lining up new allies. On Dec. 9, just after his appointment was announced, the railroad CEO rang up Intel Chairman Andre S. Grove, whom he got to know on the Conference Board task force. Among the subjects discussed: introductions to other high-tech leaders to gauge their concerns. "I feel good that he has reached out," says Grove.

Diplomacy will be crucial as Snow tries to win over Congress and Wall Street alike. After the blunt but prickly O'Neill, Snow's smooth style may be just what George W. needs.

By Joseph Weber in Chicago, with Richard S. Dunham and Lorraine Woellert in Washington and Ben Elgin in San Mateo, Calif.



COMMENTARY

By Mike McNamee and Amy Borrus

THE SEC NEEDS A REFORMER, NOT A PRETTY RESUME

If the right résumé and good intentions were all that mattered, William H. Donaldson would be just the man to lead the Securities & Exchange Commission. As co-founder of a brokerage firm, CEO of the New York Stock Exchange, and founding dean of the Yale School of Management, Donaldson has the experience to know how Wall Street can mistreat investors and what needs to be done to set it straight. Colleagues praise his leadership and political savvy—both sorely needed at a battered SEC. And in nominating the 71-year-old Donaldson on Dec. 10 to chair the agency, President George W. Bush is once again reaching into the past for a reassuring image of integrity.

But investors should not be satisfied with parking credentials or pledge to crack down on boardroom offenders. The crisis in Corporate America demands serious reforms—and on many key issues, Donaldson's long career record is silent at best.

DONALDSON HAS THE POLITICAL SAVVY TO AVOID PITT'S SNAFUS

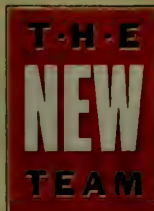
Last spring, when lawmakers were hammering out new codes to guide corporate governance, Donaldson was a director at Aetna Inc., defending limits on shareholder rights that a Harvard University professor termed "dictatorial." Donaldson "has not been an exemplar or an advocate of good corporate governance," says Nell Minow, editor of The Corporate Library, a corporate governance research service.

Donaldson's record on accounting and enforcement issues is worrisome, too. At the NYSE in the early 1990s, he fought to let foreign companies list their stocks without meeting tougher U.S. accounting rules. And in 1999, the SEC censured the Big Board for failing to catch illegal trading by floor traders on his watch.

If he wants to rise above this

record, Donaldson will have ample opportunities at the SEC. The new chairman's first priority must be to revitalize the stillborn Public Company Accounting Oversight Board by naming a strong, independent leader. Donaldson may have to butt heads with the White House, which appears reluctant to back reformers for that job.

He'll be feeling the heat from corporate and financial interests, too. They are lining up to undermine rules the SEC must write to implement the Sarbanes-Oxley corporate reform act. So far, the agency is



taking a hard line, even going beyond what the new law requires in many cases. But he "will have to withstand an avalanche of lobbying," warns Patrick McGurn, vice-president at Institutional Shareholder Services, which advises pension funds on proxies.

On Wall Street, Donaldson must lock in permanent rules to ensure that analysts give investors unbiased stock picks. He'll also need to break up the Street's cozy method of doling out shares in initial public offerings.

Corporate cleanup isn't the only hot issue awaiting the new chairman. Rules to protect investors as stock trading migrates to cyberspace are

long overdue. And a shareholder-oriented chairman must use his bully pulpit to educate the investor class on protecting its 401(k)s from the next bear market.

Donaldson also has to fight for his own agency. Outgoing Chairman Harvey L. Pitt, who resigned on Nov. 5, wouldn't go to the mat for the \$300 million spending boost the chronically overworked agency needs. If Donaldson wants to rally his troops—and stop key staff from rushing for the exits—he must persuade Bush to boost funding immediately, rather than pledging hikes for 2004. Fortunately, Donaldson has leadership skills and the savvy to avoid Pitt's political snafus.

Donaldson's record of shaking things up is more mixed. The brokerage he helped found in 1959, Donaldson, Lufkin & Jenrette Inc., defied the NYSE when it became the first member firm to go public. But as the NYSE's CEO, Donaldson couldn't get the Big Board's specialists to open trading 30 minutes earlier to help over-

WILLIAM H. DONALDSON

STRENGTHS A politically attuned Wall Streeter who will help restore confidence to battered markets and boost morale at the tarnished SEC

POTENTIAL PROBLEM

Lacks experience in the accounting issues roiling Corporate America as well as the reform credentials to get the job done

BIGGEST CHALLENGE

Defying GOP, corporate, and financial interests to keep reform on track

BAGGAGE Advocated weak accounting for foreign companies while CEO of the NYSE and was lavishly rewarded as interim CEO of Aetna, a corporate governance laggard

seas investors. And he resisted linking the NYSE to fledgling electronic exchanges that made it faster and cheaper for investors to trade stocks.

Which Donaldson will show up at the SEC? His background makes him a chairman straight from Central Casting. But with the job of reform so far from finished, just looking the part won't be enough to assure investors the markets aren't rigged.

With Emily Thornton and Heather Timmons in New York

HOW TO KEEP UNITED FLYING

Glenn F. Tilton
Chairman, President, and CEO
UAL Corp.
1200 E. Algonquin Rd.
Elk Grove Township, Ill. 60007

Dear Glenn:

Well, you've certainly had an eventful few months. Since taking over United Airlines Inc. on Labor Day, you have assembled a cost-cutting plan to lower labor expenses by almost \$1 billion a year, in the hopes of obtaining the \$1.8 billion in federal loan guarantees that would permit UAL to avoid bankruptcy. Of course, that's not how things turned out. Even before United's unions had finished voting on the givebacks, the Air Transportation Stabilization Board dismissed your application, calling it "unreasonable." It can't have been easy when, faced with \$920 million in overdue bills, you were forced on Dec. 9 to seek Chapter 11 bankruptcy protection. As you know, United's the biggest business failure in U.S. aviation history and the sixth-largest ever, measured in terms of assets.

Things don't look good. You've said United is losing \$20 million a day. Moreover, your new lenders are demanding that you come up with "substantial labor savings" within the next few months, or they'll chop off your funds. They haven't specified publicly just how deep the staff cuts must be, but as you note in the company's bankruptcy filing, you would have to pare your payroll expenses by \$2 billion a year, or 28%, to match Continental Airlines Inc.'s labor costs. And equaling low-cost rival Southwest Airlines Co. would mean \$200 million beyond that. That's big money. No wonder many of your rivals are betting against you. In fact, several airline insiders tell me there's a more than 50% chance UAL will wind up in a Chapter 7 liquidation.

But Glenn, let me assure you that you could still end up as the man who saved United Airlines. How? Obviously, you must start by quickly wringing huge cost reductions from labor. The good news is that bankruptcy should be a big help. Labor leaders know a judge can toss out existing contracts. But for now, there's no reason to go down that

road. You would be better off negotiating. You can't risk turning your workers into adversaries—who would scare off passengers. Instead, go around labor leaders and appeal directly to the rank and file, whose votes you'll need for any givebacks. And be frank: What would they prefer—a pay cut or no job? That will help convince veteran pilots, who know they would never get such big bucks at another airline. Ordering pay cuts of up to 10.7% for all managers and executives, as you did on Dec. 9, was a good first step showing that no one is exempt from sacrifice.

Sure, the lion's share of savings will have to come from wage concessions. But you could also save tons of money by getting rid of the silly work rules that United still abides by. To take just one example, why must there be a fully licensed mechanic, making up to \$102,000 a year, at the gate every time a plane is pushed off? One analyst says eliminating that one rule could save \$200 million a year. In UAL's bankruptcy papers, you also point out how, by carefully picking days, a \$300,000-a-year jumbo-jet pilot can take a full month of paid time off by using two weeks of vacation. That's nuts.

Of course, simply lowering labor costs won't save United. You're also still flying too many planes on too many unprofitable routes. Even with the 6% reduction you have planned for next month, your operations need further trimming. You'll want to keep United's hubs and international routes—they're your crown jewels. But you should move quickly to retire more of those costly-to-fly big planes and turn over some routes to part-



BESIEGED:

Tilton may have only until spring to avoid liquidation

ners flying regional jets. And while I'm sure it's hard to admit rivals may be doing a better job, you should also copy the "rolling hub" experiment American Airlines Inc. is trying. By spreading flights out over a day instead of bunching them together at hours consumers prefer, you would get more hours out of your planes and flight crews. While you're at it, you should also try American's current test of reducing last-minute business fares to drive traffic.

What about those pesky low-fare encroachers like Southwest? To blunt their challenge, you'll need to resurrect UAL's low-cost shuttle subsidiary. Flying point-to-point with one aircraft type, à la Southwest and JetBlue Airways Corp., is the way to go there. The strategy worked against Southwest in California in the 1990s—till the unions saddled the shuttle with their burdensome work rules.

And let's get real about one thing: You need to dump UAL's employee stock-ownership plan, which gave workers equity control of the carrier and special powers on its board of directors. Creditors or potential outside investors, who could include alliance partner Singapore Airlines or investment firms such as David Bonderman's Texas Pacific Group, will

probably be the ones in control if UAL comes out of bankruptcy.

Obviously, none of this will be easy. Since the airline industry was deregulated in 1978, nearly 200 carriers have disappeared, including big guys like Eastern, Pan Am, and Trans World Airlines. Only one airline from the era of regulation, Continental, has survived bankruptcy. Why not take a lesson from its experience? The Houston carrier slashed labor expenses, but it didn't really succeed until manage-

ment turned workers into allies by giving bonuses for such things as on-time performance. Continental kept its hub-and-spoke network, but it stopped trying to serve every market.

The next few months will determine your legacy. If you can get labor on board—without completely destroying morale—you'll have time to put together a new UAL that could beat your hub-and-spoke rivals and stymie the advance of low-fare airlines. But if you fail, UAL will

fail. Creditors figure you've got till next spring to show big progress. If you go beyond that, they're likely to push for liquidation. So the pressure is on. Time to put down this magazine and get back to work.

Yours sincerely,
Michael Arndt,
with Wendy Zellner

BusinessWeek online

For an interview with UAL CEO Glenn Tilton, go to www.businessweek.com

LINES

UGHT IN ITED'S OWN DRAFT

How will Boeing's finance and leasing business be affected?

These are dark days for Boeing. Witness plummeting jet orders, a shrinking share of the commercial-plane market, massive layoffs, and likely cancellation of its great hope for the future, the Sonic Cruiser project. And United Airlines' bankruptcy spells trouble for Boeing. The carrier is the jetmaker's financing unit \$1.3 billion for the purchase of a dozen Boeing jets.

It just goes to show how much the world has changed since Boeing created Boeing Capital Corp. three years ago. Back then, the Chicago-based aerospace giant promoted its financing arm as a potent source of profits and double-digit growth. The idea, modeled on General Electric Co.'s ultraprofitable Capital Corp., was simple: The company would not only book profits on sale of jetliners but also earn extra on the deals to lease or finance those planes.

As long as the economy was strong, the concept worked perfectly. Net profit from leasing doubled, from \$78 million in 1999 to \$151 million in 2001, as the value of Boeing's leased equipment rose from \$2.9 billion to \$11.5 billion. But the global downturn has sunk Boeing Capital as well. For the first nine months of this year, it has earned only \$6 million. In the third quarter, it took a \$149 million charge to boost re-

serves and reflect falling aircraft prices.

Now, United's massive bankruptcy filing exposes Boeing to new risks. In the event United and Boeing can't agree to new financing terms, Boeing will have to repossess about a dozen jets. That means months of lost revenue and the prospect of placing the planes back in service with other carriers at much lower rates. Says James F. Palmer, president of Boeing Capital: "[We are] obviously concerned by United's decision to file for bankruptcy." Still, he insists that the finance unit will be able to ride out the United storm.

Boeing isn't the only aircraft lessor to take a hit, which means already-weak aircraft prices probably will sink further. With United likely to ground more airplanes as it cuts costs, others will soon be trying to resell their planes or cut new deals at rock-bottom prices, too. *The Airline Monitor*, an industry newsletter, calculates that surplus aircraft now account for 13% of the world's fleet—the highest ever. "The risks are

going up and the quality of the loans [is] going down," says William C. Becker, president of Bellevue (Wash.)-based aircraft appraiser DCB Consultants.

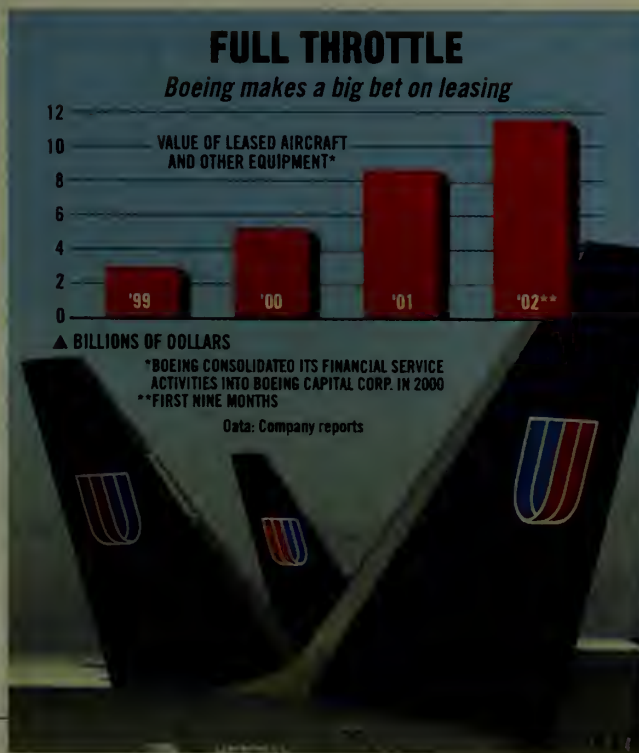
Yet Boeing Capital is uniquely vulnerable. Unlike the diversified GE Capital, where just 3% of \$58 billion in revenues are from leased aircraft, more than 80% of Boeing Capital's business is aircraft financing. And Boeing archrival Airbus has steered clear of leasing altogether. Says John J. Leahy, Airbus chief commercial officer: "It's a concentration of risk we'd prefer not to have."

Boeing Capital has other headaches, too. Latin America's biggest airline, Brazil-based Varig, is teetering and could leave Boeing Capital on the hook for another \$700 million and 11 McDonnell Douglas airplanes. Nearly half of Boeing Capital's fleet are older MD aircraft or the slow-selling 100-seat Boeing 717. Most of those planes are impossible to sell or lease for a decent price.

United has 60 days to renegotiate its loans and it will likely hold on to its planes. But it will be in a position to hammer down financing terms. Already, U.S. Airways is demanding a 25% reduction in payments from its lessors. Says George Hamlin, analyst for Global Aviation Services: "Prices are coming down, and it's only going to get worse."

So much for Boeing's financial-services growth strategy. Says Richard Aboulafia, Teal Group Corp. aerospace analyst: "This downturn really blindsided them." With no letup in sight, it could be a long while before Boeing Capital sees a break in the clouds.

By Stanley Holmes in Seattle, with Carol Matlack in Paris



THE TARMAC: A hard-to-lease fleet

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and your employees,
and your customers.

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Who could be?

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enough talent
to handle a major initiative?

The whole thing
start to finish?

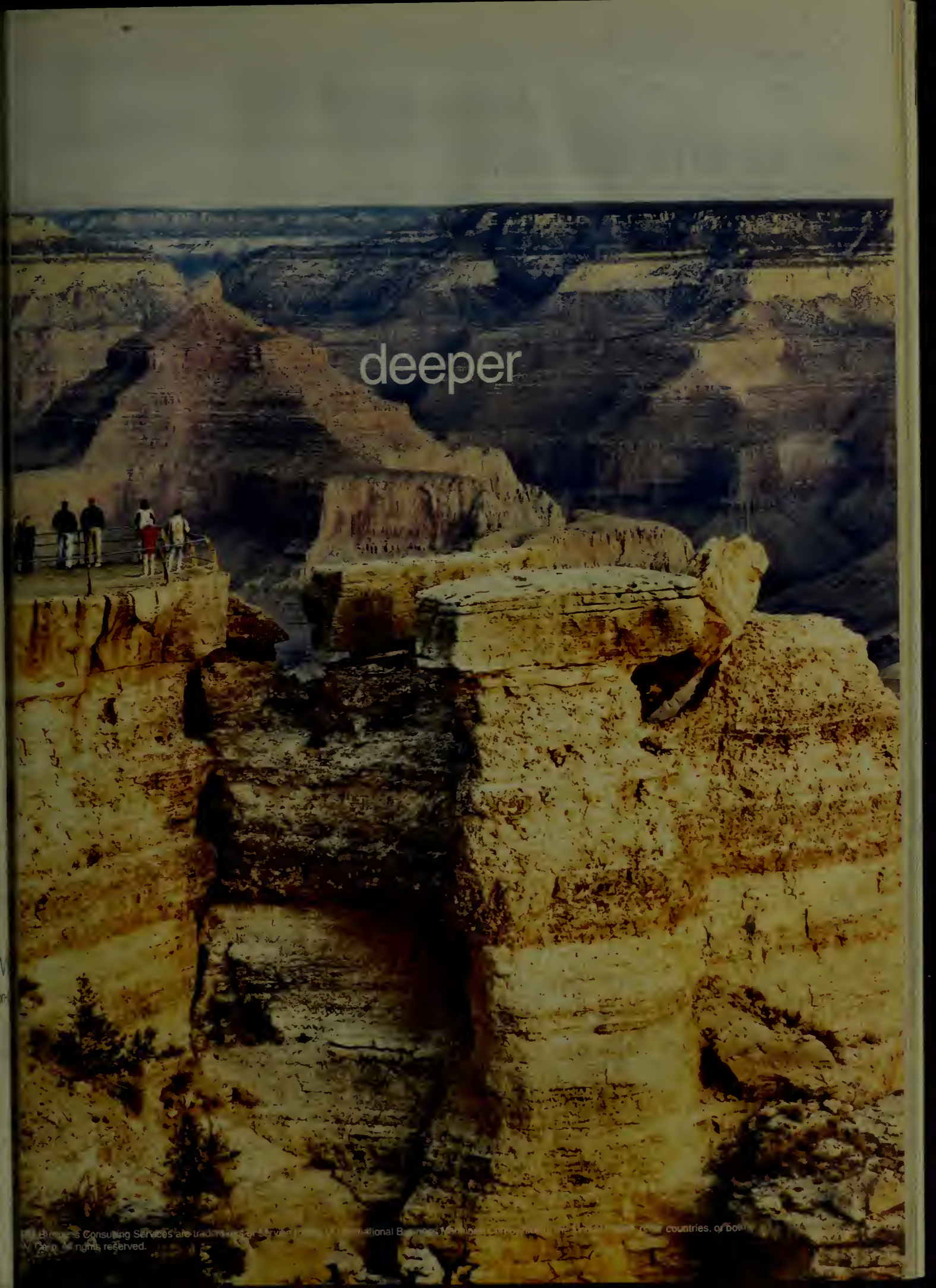
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TELECOMMUNICATIONS

THE BIG BOYS' MAD DASH INTO WI-FI

The wireless Internet is exploding. But will anyone pay for it?

It started just three years ago, when techies began programming their laptops with a new wireless standard and jerry-rigging antennas to their broadband Internet connections. Poof! Suddenly, they could move around in their homes or offices, even into the backyard, and stay connected to the Net.

Now, this technology, known as wireless fidelity, or Wi-Fi, is taking off. Vast, informal networks are sprouting up. Zippy Wi-Fi connections, each one with a range of some 300 feet, now blanket entire neighborhoods from New York to Stockholm to Hong Kong. Some 2 million mobile surfers in North America already use Wi-Fi, and Gartner Inc. expects the number to double by next year. The surge in demand has prompted the Federal Communications Commission to find ways to set aside more spectrum for Wi-Fi.

Wi-Fi is all the rage, and finally, the struggling tech industry is gearing up to cash in on it. In the next year, Dell Computer Inc. will begin equipping practically all of its laptops with Wi-Fi connections. Sony Corp. is putting it into a host of electronic gadgets. Intel Corp., which is investing \$150 million in Wi-Fi startups, plans to release new chips with Wi-Fi receivers by spring. And on Dec. 5, AT&T, Intel, and IBM launched a new company called Cometa Networks. Its goal is to bundle thousands of Wi-Fi connections, called hot spots, into one nationwide network—and to convert this grass-roots phenomenon into a bona fide, billable business.

How will it work? Phone or cable com-



panies will either buy access from a wholesaler such as Cometa or stitch together a network themselves. Then they'll likely offer subscribers national or regional Wi-Fi service for an extra \$10 or \$15 a month. In this new business, which analysts expect to take shape in consumer and corporate markets within a year, a subscriber in San Francisco will be able to take the laptop or PDA to Detroit or Atlanta, knowing that it links up wirelessly to the Net in airports, hotels, and probably even ballparks. "My feeling is that Wi-Fi starts to become pretty prevalent during the second half of next year," says Christopher Fine,

CAN WI-FI DELIVER?

BACKERS SAY...

- It will lift productivity by unchaining workers from their desktops
- Cheap home networking will prompt consumers to buy new gear
- Companies will find it easier to rig up wireless networks off-site

CRITICS SAY...

- No one knows if Wi-Fi provides a decent return on investment
- It is now too easy for hackers to penetrate Wi-Fi networks
- A critical mass of nodes is still two or three years away

an analyst at Goldman, Sachs & Co.

But the path to Wi-Fi riches is strewn with obstacles. Lots of users already have Wi-Fi hookups in their homes but will insist on an extra charge to take the Net on the road. And before Wi-Fi conquers the corporate world, the industry must cope with strong security software. Last May, retailer Best Buy Co. temporarily shut down its wireless network after a

security analyst in a parking lot managed to intercept data, including credit-card numbers, from the company's wireless cash registers. Best Buy subsequently plugged the gap and turned the network back on. Analysts predict that software protections will be sturdy enough for the broad corporate market by next year.

Wireless phone companies are facing perhaps the biggest challenge of all. The industry is gearing up for a multi-billion-dollar rollout of high-speed wireless networks known as Third Generation, or 3G. Soon, Wi-Fi may offer many of the same mobile services

True, it works only in stationary

hot spots, and not, say, in a moving car. But it's far cheaper. Cometa, for example, is hoping to pull together its Wi-Fi network for a mere \$30 million—chickadee feed by 3G standards. The danger is that customers will log onto the mobile Internet through Wi-Fi and blow off 3G.

For now, phone companies have little choice but to race into Wi-Fi. T-Mobile USA Inc., which has already set up hot spots in 2,000 Starbucks Corp. cafés, is spending \$100 million to build a nationwide Wi-Fi network. The goal: to hook users on Wi-Fi, then to push them toward 3G. "It's going to be difficult for anyone to make a business case just serving Wi-Fi," says John W. Stanton, chairman of T-Mobile USA. "It's a piece of the puzzle."

It's by far the hottest piece of the mobile Internet. With the price for home networks dropping below \$200, hardware sales are expected to grow from about \$1.5 billion to \$2.3 billion this year, according to Synergy Research Inc. The trick now is to lure all these home networkers outside, onto the broader Wi-Fi networks—and bill them for it. It's the tech sector's next big step toward mastering the mobile Internet.

By Heather Green in New York, with Ben Elgin in San Mateo, Calif.

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been a blur.

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CHEVROLET  CORVETTE

EDITED BY MONICA ROMAN

COKE: 'THE TANK' HEADS TO THE FRONT

WHEN STEVEN HEYER WAS president of Turner Broadcasting System, staffers nicknamed him "The Tank" for his hard-charging ways. And from the moment he joined Coca-Cola as executive vice-president and president of Coca-Cola Ventures in March, 2001, Heyer has made his mark. He reshuffled Coke's ad agencies and shook up its product mix with a number of brand extensions such as Vanilla Coke. Last year, Heyer even persuaded CEO Douglas Daft to swallow his pride and pull the plug on his planned joint venture in juice and snacks with Procter & Gamble. But it's clear that Daft and the board like what they see: On Dec. 11, Heyer was named Coke's president and chief operating officer—a move that clearly positions the 50-year-old former ad executive and management consultant to

succeed Daft, 59, when he retires in coming years.

THE CENDANT DRAGNET DRAGS ON

THE PRESSURE IS MOUNTING on former executives involved in the Cendant accounting scandal. On Dec. 11, a federal grand jury indicted former Cendant Chairman Walter Forbes and former Vice-Chairman Kirk Shelton on additional charges, including insider trading for Forbes. The two were previously indicted on other charges, including securities fraud. The indictments stem from the 1998 accounting blowup in which executives at the former CUC International, which merged with the franchising company HFS to form Cendant in 1997, were alleged to have booked \$500 million in fictitious revenue over several years. An attorney for Forbes declined to comment while Shelton's attorney says his client "vigorously denies all the charges."

CLOSING BELL

TRIPPED UP

Skechers USA shocked investors on Dec. 9 by predicting fourth-quarter sales would be 14% less than expected. The teen-oriented shoemaker is facing weak consumer spending and changing tastes. Investors knocked 42% off the shares, which recovered slightly to close at \$8.10 on Dec. 11.



WHAT PRICE TO FIX WORLDCOM?

IS FORMER HEWLETT-PACKARD President Michael Capellas getting rich off WorldCom's woes? U.S. District Judge Jed Rakoff, who is overseeing federal investigations of the fallen telecom giant, thinks so. Rakoff has ordered WorldCom to explain why Capellas' \$3.5 million salary and signing bonus isn't excessive. WorldCom says Capellas' salary is in line with the job of rebuilding the \$30 billion company, now in bankruptcy. More important, WorldCom General Counsel Michael Salsbury notes that court-appointed monitor Richard Breeden hasn't objected to Capellas' package. Breeden could not be reached for comment, but observers believe that Rakoff will ultimately accept Capellas' pay as fair.

HEADLINER: THOMAS PRITZKER

POINT MAN IN A FAMILY FEUD

Hyatt Chairman Thomas Pritzker has feted a Chinese premier and brokered global deals—but keeping his feuding family apart its \$15 billion empire may prove a humbling challenge. The 52-year-old lawyer will likely stay in charge of Hyatt—as long as he keeps the support of cousins Nicholas and Penny Pritzker, the other members of the family's ruling triumvirate, sources say. But the trio is now seeking ways to cash out eight other cousins—probably by selling parts of the family's \$6 billion Marmon Industries Group



conglomerate and perhaps by taking Hyatt public. "We can't foreclose our options in the future, but I can say we have plans to take Hyatt public in the next several years," says Hyatt's chief.

The family's woes have become public because of a lawsuit by Liesel Pritzker Bagley, a Columbia University freshman. Bagley has sued her father Robert, and cousins seeking a bigger share of the pie. And the cousins, in a rare public statement, said on Dec. 10 they "regret" her action and are trying to resolve the dispute.

Joseph W.

A BRISKER WALK DOWN MAD AVE

IS THE DEEPEST ADVERTISING slump in decades finally fading? Media buying agency Universal McCann is projecting a 5% gain in U.S. advertising spending next year, to \$249.3 billion. Coming after an expected 2.6% increase this year, the projected 2003 levels would bring ad spending above the record \$247.5 billion hit in 2000, says McCann. Others, such as media buyer Zenith Optimedia and economist Jack Myers, aren't as upbeat, but are predicting gains in the 2% range.

A REALLY BIG FREE-TRADE ZONE

THE BUSH ADMINISTRATION moved a step closer to its goal of a hemispheric free-trade zone on Dec. 11 by concluding a deal with Chile. The comprehensive pact would re-

duce nearly all tariffs on lateral trade in manufactured goods to zero once Congress approves, probably by next fall. Agricultural duties will be phased out over 10 years. The Administration is playing catch-up since Canada already has deals with Mexico, and Canada. But the White House is hoping the deal will put pressure on Brazil to drop its opposition to a 34-nation Free Trade Area of the Americas. President Bush plans to open free-trade talks next year with Central America.

ET CETERA...

- Northrop Grumman completed its \$6.8 billion merger with TRW.
- Raytheon Chief Financial Officer Frank Caine resigned.
- The National Transportation Safety Board blamed Alaska Airlines for the crash of Flight 261.

PAUL MAGNUSSON

FROM RIDGE'S MEGAMERGER: ADVICE FROM CORPORATE AMERICA

After Hewlett-Packard began its massive merger with Compaq Computer last May (page 52), CEO Carly Fiorina flew into Washington with three top executives to brief another lieutenant with an even more daunting task—Homeland Security boss Tom Ridge. Fiorina spent much of Oct. 4 sharing her playbook with Ridge at Fort McNair, a stately military base overlooking the Potomac.

Fiorina isn't the only corporate manager whose advice Ridge and his transition team have sought as they prepare to create the Homeland Security Dept. out of 22 federal agencies with 200,000 employees. Already, scores of business leaders, management consultants, and academics are lending their expertise.

Examples. The brains of AT&T, ExxonMobil, Wal-Mart, Lowe's, and Raytheon are among the companies that have been picked.

But that business consulting makes sense because Homeland Security has to wrestle with the same issues that come from Corporate America's megamergers—governance, cash flow, logistics, incompatible technology, overlapping jurisdictions, and clashing cultures. *BusinessWeek* talked with some of the experts and other merger gurus. Here are the best tips:

Get the ground running. Government mergers drag on. "The 1986 Pentagon reorganization took four years because they were trying to get it absolutely right," says Paul B. Davis, a professor at the Industrial College of the Armed Forces. "My advice is, don't go for the optimal—go for a workable solution and then adapt."

Be audacious. President John F. Kennedy had no idea whether the nation could land a man on the moon by the end of the decade when he announced the goal in 1961. A fail-safe safety system for America's 103 nuclear power plants would be a challenge to set.

Take a hint from Neutron Jack. At General Electric, Jack

Welch created a senior executive service and moved executives around from office to office every couple of years. That creates a cadre of experienced managers who can see beyond the horizon and offer broader solutions to problems. "Ridge has to avoid the career-employee attitude that 'This is the way we do it because we've always done it this way,'" says Kevin P. Varney of Business Executives for National Security.

Create a red-flag mechanism. As Britain's First Lord of the Admiralty, Winston Churchill worried in 1940 that he was hearing only good news from his underlings. So he set up a committee to give him the "brutal facts." Ridge needs the same sort of early-warning system.

Get a smaller board of directors. Congress needs to reorganize, too, or Ridge will spend all his time testifying before petty tyrants such as Representative Don Young (R-Alaska), who heads a committee overseeing the Coast Guard. When told the Coast Guard was to be moved to Homeland, Young protested to President George W. Bush: "This is personal!"—as if he mattered more than the nation's defense. Ridge ought to answer to no more than two House and two Senate panels, like other large departments do.

Pay attention to culture. Uniformed officers of the Border Patrol, Coast Guard, Secret Service, and Customs Service are concerned about whether their uniforms and patches will be changed. Such things matter for morale and message. As long as the mission statement is the same for all, preserve local culture.

No doubt, Ridge has a difficult task ahead. "How do you even measure success when your most important goal is having nothing to report?" asks James C. Collins, author of *Built to Last: Successful Habits of Visionary Companies*. No one has written that book yet. If we're lucky, Ridge will give it a shot when he retires—mission accomplished. ■



COAST GUARD: A congressional fiefdom?

CAPITAL WRAPUP

THE SINS OF THE CARDINALS

Conservatives continue to tighten the screws on the 13 House appropriations subcommittee chairmen, the so-called college of cardinals. If the cardinals, known for porking up pet projects, don't hold the line on discretionary spending in 2003, the Right will go after them. Leading the campaign: Americans for Tax Reform chief Grover Norquist, an ally of incoming House Majority Leader Tom DeLay (R-Tex.). House bosses recently rationed the seniority system for

picking cardinals and can strip them of their posts if they don't get approval before sending bills to the floor.

TOM, DICK, AND HARRIED

► Senate Democratic leader Tom Daschle (S.D.) and his former House counterpart, Dick Gephardt (Mo.), have been roasted by pundits for failing to craft an effective economic message for the 2002 elections. Democrats seem to concur. With the pair mulling '04 Presidential bids, a Dec. 2-4 Marist Institute poll of New Hampshire voters finds Gephardt and Daschle run-

ning far behind Al Gore and Senator John F. Kerry (Mass.). Gephardt, a longtime friend of labor, polls just 5%, including a meager 5% in union households. Daschle got a measly 3%.

A FREE-TRADE PROTECTIONIST

► The National Foreign Trade Council reinstated its Free Trade Award after 17 years and honored Commerce Secretary Donald L. Evans on Dec. 10. Some free traders find the choice curious. They blame Evans for decisions to impose tariffs on imported steel and Canadian lumber.

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BRAC

QATARI AIRFIELD Even America's friends in the region are on edge

Contents

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The U.S. wants to spread democracy throughout the Mideast. Tall order

Tucked away in the elegant confines of the Al Faisaliah commercial complex in Riyadh's Olaya district sits a modest research center run by one of the sons of the late King Faisal of Saudi Arabia. Here, Turki Al-Faisal ponders the growing crisis in the Mideast, what it means for U.S.-Arab relations. Until a little over a year ago, Al-Faisal was the chief of Saudi intelligence, a position that put him in close contact with U.S. policymakers. Yet he has little reassuring to say about the Americans now. He predicts that a U.S. invasion of Iraq will be a "bloody" disaster. "Lots of Iraqis are going to die, perhaps Americans as well," he says. He says the U.S. is behaving like an imperial power. "Any country or society becomes dominant inevitably wants to change the world in its own image," he says. "America is like this now. Look at Alexander the Great did, and the British."

These words at first seem over the top coming from a senior member of the House of Saud, a close U.S. ally for more

BY STANLEY REED

the biggest thing worrying the Arab regimes is American idealism—a full-fledged Wilsonian need to change things for the better. While the U.S. has long been deeply involved in the Middle East as a guarantor of the international order and a trading partner, it has mostly refrained from trying to impose American values. In the world after September 11, the U.S. is becoming a much more intrusive force, demanding changes in how institutions such as schools and charities function.

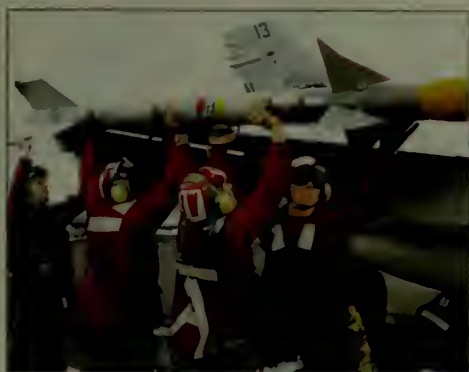
The new "with us or against us" approach worries not just states such as Syria and Iran that have traditionally been estranged from the U.S. America's friends in the region are also on edge. "They have lost the unconditional support of the U.S.," says Vahan Zanoian, president and CEO of Washington-based energy consultants PFC. "Their own internal weaknesses are far more exposed." There is a risk that the tense atmosphere is helping militant groups recruit more adherents. "You don't have to be a rocket scientist to figure out we are worse off than after September 11," says one U.S. diplomat.

ING FOR WAR

half a century. After all, despite their protests, the Saudis are likely to cooperate with America's prosecution of the war—as will other Arab states. And few Arabs miss Saddam if he is toppled.

Al-Faisal's harsh words, however, represent a huge swathe of Arab opinion. The ruling elites of the Mideast—and much of the Arab street—are alarmed at the turn American policy has taken. They think this is the wrong moment for a war, the wrong enemy to fight. They think Saddam is boxed in—and they aren't impressed with the Bush Administration's claims about Iraq's weapons programs or Saddam's links to terrorism. "In the eyes of the Arab world, this is a bad war, if it happens, while [the Persian Gulf War in] 1991 was a good war," says Richard W. Murphy, a former U.S. Ambassador to Saudi Arabia and Syria. With troops massing in the region, the march to this war is under way. On Dec. 7, the Iraqis submitted a 12,000-page report describing their arsenal to the U.N. Now, the Bush Administration must decide whether to allow weapons inspections to continue—or unleash the awesome armed might of the U.S. and its allies on Baghdad.

The prospect of war is one source of anxiety. But the



SIDEWINDER Washington feels a growing sense of confidence

for as long as it takes to create a model society for the region.

This is ambitious stuff. The Mideast needs reform, and maybe, if all the pieces fall into place, Washington will be proved right. But the Arabs see this attitude as a scary reminder of what has gone before. When the British and French

BusinessWeek online

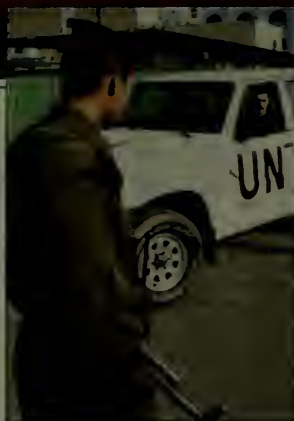
For stories on Egypt, the Arab media, and more on the Mideast, go to the December 23 issue online at www.businessweek.com

SPECIAL REPORT

rushed in to fill the vacuum left by the fallen Ottoman Empire, they intended to build a series of peaceful, pro-Western regimes. Instead they constructed artificial states, based partly on unnatural borders and eventually armed to the teeth by their European sponsors. The result was the new Middle East, whose wars, coups, and upheavals have shaken the world for decades.

That's why others in the region see change coming, too, but of a different sort. "I see the Middle East being transformed into a new era of confrontation between the U.S. and Iraq and Israel and the Palestinians," says Amr Moussa, Secretary General of the Arab League in Cairo.

Arabs worry that they will have to deal with any instability in Iraq that stems from an attack, and that the Americans

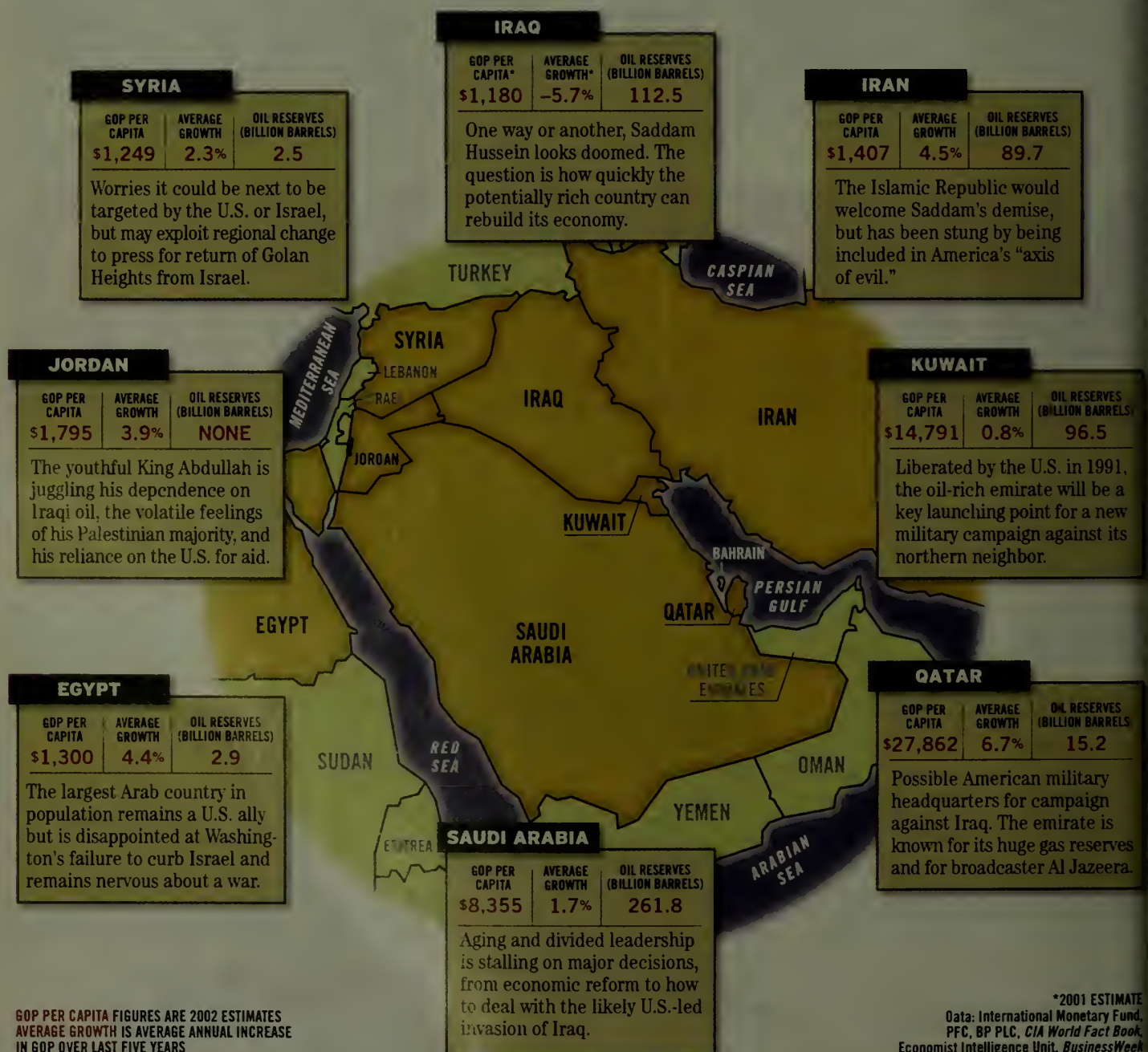


INSPECTORS Will Bush accept Iraq's report and allow inspections to continue?

will show no stomach for a long process of rebuilding a nation. Many Arab policymakers think that competing power interests will emerge in Iraq once Saddam, who restrained them, is gone. They also know a prolonged war could further stoke the passions of their own people, who are furious about U.S. support for Israel. "You could have a domino effect in other countries such as Saudi Arabia," says Mohamed Sid Ahmed, foreign affairs columnist for the leading Cairo daily, *Al-Ahram*. If war is slow and ugly, it could inspire demonstrations or attacks on American targets.

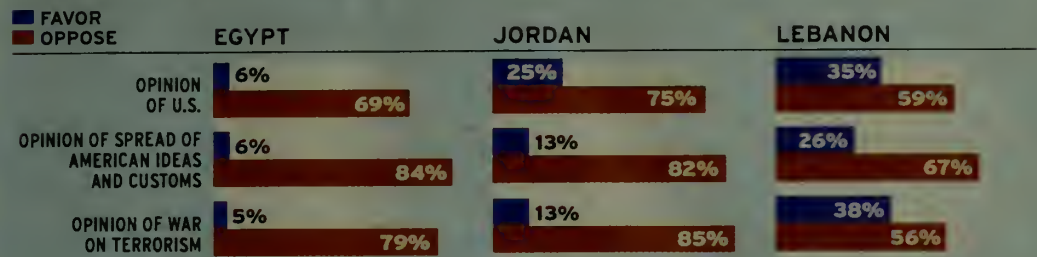
But what if the war in Iraq goes well? That outcome also

IRAQ AND ITS NEIGHBORS AS THE TENSION RISES



HOW THEY VIEW AMERICA

Citizens of Egypt, Jordan, and Lebanon recently voiced strongly negative opinions of the U.S., American customs, and the war on terrorism



Data: Pew Global Attitudes Project

atens the other Arab mes. A weak, U.N.-sanctioned Iraq wasn't so bad for n. Iraq has been unable compete with other oil producers for influence, and U.S. restrictions have kept Iraq's oil production down—leaving room for the other producers' output in a weak market. They fear that a new regime could double or triple production, hammering prices and threatening OPEC's cohesion.

At the same time, the Arabs must shoulder responsibility for their own predicament. Iraq's 1990 invasion of Kuwait should have served as a warning to these regimes—particularly the oil producers—to put their houses in order. In most case, Arab states have taken only minor action to broaden their political bases. True, the Saudis took a key step in creating the Shura Council, a national assembly. But they made it an appointed rather than an elected body. Almost no Arab country has figured out how to unleash the kind of economic growth that creates jobs and dampens the appeal of radicalism. President Hosni Mubarak of Egypt and Saudi Arabia's Crown Prince Abdullah have dabbled with reform, but recalcitrant bureaucrats have gummed up the works. Prince Alwaleed bin Abdulaziz, the Saudi financier, gives his uncle the Crown Prince an "A" for diagnosing the kingdom's problems, but he only awards the government a "C" for implementation. "From the Crown Prince's point of view, the Crown Prince is going at 100 miles per hour, while the bureaucracy is going at half-speed," says Alwaleed. "Most state political initiatives have been lackluster, too. Although the Arabs complain bitterly about the violence between Palestinians and Israelis, most Arab governments have done nothing to curb the suicide bombings inside Israel, which have severely damaged the Palestinian cause in the U.S. Crown Prince Abdullah's proposal earlier this year to solve the conflict might have had a greater chance of success if it had been made much earlier—when President Bill Clinton was trying to broker a peace in

late 2000. "I believe that if the Saudis had been that forthcoming [then], we would have had a deal," says Madeleine K. Albright, who was Secretary of State in the Clinton Administration.

Despite these problems, many in the region yearn for change. On a recent day in Riyadh, Mohammed Al-Sarhan, managing director of Al-Safi-Danone Co., a Saudi-French joint venture, groused that he could not figure out how to hire a highly qualified young Saudi woman. The problem: The *mutawas*, the religious police, would go into conniptions if they discovered a woman working alongside men. "It is frustrating to see such talented go jobless," Sarhan says. "Somebody has to start" bringing women into the top level of Saudi companies, he adds.

Such candid expressions of frustration give some Americans hope. "There is great potential for Saudi Arabia to look a lot

more like the U.S. in 20 years," says an American official in Riyadh. "There is a well-developed middle class. Islam melds well with capitalism." After all, the prophet Mohammed was a merchant, Saudis have a long tradition of trade, and nothing in Islamic doctrine is inherently opposed to business. A democratic Iraq might inspire such change. "It won't happen quickly, but Iraq could act as a mecca for liberals just as Egypt was" for Arab nationalism in the 1950s and 1960s, says Abdel Moneim Said, director of the Al-Ahram Center for Political & Strategic Studies in Cairo.

IN BAGHDAD War could spur the forces of Mideast modernization



But how far does the U.S. want to go? Real democracy would give an opening not only to

HOW A WAR ON IRAQ COULD PLAY OUT IN THE REGION

The scenarios depend on how long the war lasts, how hard it is to set up a government, and how neighboring states react to a new Baghdad regime

DRAMATIC REFORM

The Administration's dream is that a successful, democratic Iraq pursuing free-market economics would eventually become a beacon for regional change. Iraq's example would influence restrictive regimes such as Saudi Arabia and Egypt, as well as Gulf states that are already pursuing reforms. Gradually, popularly elected governments would wrest power from authoritarian regimes.

LITTLE CHANGE

The U.S. could oust Saddam, but the outcome might not influence the region. A restive Iraqi population might spur the U.S. to pull out quickly and hand power to a gentler strongman who would be unlikely to open up much economically and politically. Instead of true representative government, the region's leaders could allow parliaments that give opposition members some voice—but limited clout.

CHAOS

Washington's nightmare would be a military operation that prompts Saddam to unleash weapons of mass destruction on countries that let the U.S. use their bases, and on Israel. A chain reaction among Islamic extremists could destabilize countries such as Jordan, Egypt, or Saudi Arabia. A series of military coups could put a ruler unfriendly to the U.S. in power in Iraq, creating a U.S. policy disaster.

moderates but also to governments much less willing to do America's bidding—or even extremists. A recent poll by the Pew Research Center for the People & the Press found that 69% of Egyptians had an unfavorable opinion of the U.S. A Zogby International survey earlier this year found that 87% of Saudis shared that view. The main reason: U.S. support for Israel. If fair elections were held in most Arab countries, the Islamists would stand a strong chance of winning a substantial vote.

Already, Islamist religious scholars circulate anti-U.S. tracts on the Internet and by hand in Saudi Arabia. "Today it is Iraq's turn: Tomorrow it will be the turn of anyone who resists Westernization and secularization," says one. The House

of Saud's early opposition to a U.S. invasion has won it more credibility among Islamists. "We feel that they [the royal family] are more with us than they have been in a long time," says Mohsen Al-Awajy, an Islamist who spent four years in jail for his role in a campaign against corruption.

The rulers of most Mideast countries have been around for decades. They have outlasted many changes in government and policy from Washington. Will they survive the era of uncertainty the fall of Saddam will usher in? "The leadership here is always forward-looking," says Turki Al-Faisal. Those leaders will soon be put to the test.

With Stan Crock in Washington

PRIMING IRAQI PUMPS

After Saddam, huge investment will be needed

Sharif Ali bin AlHussein holds court in a London drawing room full of pictures of his Hashemite relatives. Pride of place over the mantel goes to a portrait of his cousin, Feisal II, Iraq's last king, who was gunned down in Baghdad in July, 1958, during a coup. Originally from Mecca, Hashemite kings reigned in Jordan and briefly in Syria after World War I, as well as in Iraq. Only the Jordanian branch has kept the throne.

Sharif Ali is determined to return to Baghdad. While he's unlikely to wield much real power in post-Saddam Iraq, he hopes to play at least a titular role. A courteous, 46-year-old ex-banker, he chairs the Iraqi National Congress, a coalition working for the overthrow of Saddam Hussein. Sharif Ali is ready, if asked, to return to Iraq as constitutional monarch after the overthrow of Saddam. "Our consultations indicate the Iraqi people feel restoration of Hashemite rule would be the best guarantee of a return to democracy," he says.

Sharif Ali's mild British voice turns cold when talk turns to the Iraqi leader. "Saddam is a dead man walking," he says. Iraqi officials are contacting the opposition, he adds, seeking to save themselves and their families. "People are looking for bolt-holes. They are not preparing to resist."

Sharif Ali also has an encouraging vision of the landscape after Saddam's demise. "Iraq [has] a government that is functioning. A week after the invasion, hundreds of thousands of civil servants will begin turning up asking what to do." He doesn't think a prolonged U.S. occupation will be necessary. But, he adds, if Iraq's economy worsens, all bets could be off. Avoiding a collapse will require massive debt forgiveness and the revival of the oil industry. Iraq's reserves are second only to Saudi Arabia's, but the Iraqi fields are filled with broken pumps and dilapidated equipment, according to the U.N. Even before any war wreaks devastation, Iraq faces billions of dollars in claims for debt and war reparations from Russia

and the gulf states.

The economy will require perhaps \$50 billion to upgrade roads, power, and health care. "Oil cannot possibly solve all of Iraq's problems," says Anthony H. Cordesman, an analyst at the Center for Strategic & International Studies in Washington. Because of a baby boom and flat oil prices, oil revenues, now mostly produced under a special U.N. program, amount to \$700 per capita compared with \$6,000 in 1980, he estimates.

Yet oil is the only card a post-Saddam government can play. The first priority will be to stabilize the fields to prevent a fall in production. Iraq will probably need two to three years to add 1 million to 2 million barrels per day to its current capacity of 2.8 million barrels, according to Adam Sieminski, an analyst at Deutsche Bank in London. With major investment, that figure could rise to 6 million in five years. Yet that might antagonize OPEC. Whoever comes to power in Baghdad must deal with the problems and potential of its oil wealth.

By Stanley Reed in London



IN THE WINGS? AlHussein with a portrait of his late cousin King Feisal

STRESSES ON IRAQ

Data: CIA World Factbook, PFC, BusinessWeek

YOUTHFUL POPULATION

Some 41% of Iraq's people are under 14, posing vast job-creation woes for any new government. Unemployment is estimated at 25%.

OVERBURDENED ECONOMY

Gross domestic product per capita has fallen by 70% in the past 20 years. The economy is almost entirely state-controlled, and industry is weak.

A STRUGGLING OIL INDUSTRY

Iraq has huge reserves, but operating fields suffer from underinvestment. The country will have to battle OPEC to boost output.

MASSIVE DEBT

Iraq's government is saddled with some \$94 billion in debt. A new regime will need to receive substantial relief.

COMMENTARY

By Stan Crock

DEMOCRACY: COULD IT HAPPEN HERE?

No Bush Administration vision is grander than the White

House blueprint for an Arab Reformation. Changing the Iraqi regime is just the start. What the Bush team would like is nothing less than a renaissance of a culture and economy that successfully competed with the West centuries ago, and now is barely read of sub-Saharan Africa. Washington's hope for rebirth is familiar: democracy, free

markets, and human rights—women included.

But can these notions finally take hold in this complex and troubled region? Not a few Administration critics dismiss the idea out of hand. While some Administration officials talk of a profound impact if Saddam Hussein goes, a recent paper from the Carnegie Endowment for International Peace dubs the prospect of a democratic domino effect from Saddam's ouster a "mirage." "Rather simplistic and utopian," notes an Arab intellectual.

Yet there is a strong argument for optimism about the Arab world, in particular if you look out beyond the next couple of years. Experts on the region, such as Zalmay Khalilzad, recently appointed the Administration's point man for post-Saddam Iraq, and Deputy Defense Secretary Paul Wolfowitz, a leading Administration thinker on national security, see more encouraging signs of change than at any time in recent history. The number of elected legislatures in the Arab world is growing, political participation by women is rising, and more nations are mulling economic reforms that could reduce the clout of existing elites. "It's in the strategic interests of the U.S. to see progress toward representative government," Wolfowitz recently told *BusinessWeek*. "Over the long run, that's the source of real stability." Three converging factors could make the arid Arab political terrain surprisingly fertile over the next decade or two—time frame Wolfowitz and other Administration officials have in mind. The first is outside pressure from forces that range from American rhetoric to the economic demands of globalization. A second is the growing realization by some in the Arab elite that the region has fallen desperately behind. The third and most important factor is the Arab world's youthful population. The Arab region is the world's youngest, with 38% of the population 14 years old or younger. Unemployment is already 15%, one of the highest rates in the developing world, and most experts agree that the economic system just can't handle the workforce growth that's coming. Elites, terrified by this demographic time bomb, have few choices. "It could be an implosion," notes Zahir Jamal, a senior official of the United Nations Development Programme's



Regional Bureau for Arab States. "Or it could be a massive incentive to renew the social contract."

Administration officials already see the pressures on the region spurring movement on the ground. Women can now vote and run for office in Qatar and Morocco. The Sultan of Oman recently decreed that everyone over 21 will be able to vote in next year's elections for the first time. As rigid as Saudi Arabia is, its de facto leader, Crown Prince Abdullah, is pressing for economic, social, and educational reform, and a crackdown on corruption. And Egyptian

BEHIND THE VEIL Political participation by women is rising in several Arab nations

President Hosni Mubarak's National Democratic Party Congress has recently called for reforms ranging from floating exchange rates to women's rights. Of course, even the most progressive regimes are far from U.S.-style democracies. While the October election in Bahrain got high marks in Washington, the country's largest Shiite political society, Al Wefaq, boycotted the vote because the legislature wouldn't have enough clout. Egypt, Jordan, and Algeria meet most standard benchmarks for popular elections, yet the legislatures do little more than rubber-stamp decisions.

Yet the Administration thinks it can successfully encourage both existing and new experiments in democratic politics, free expression, free markets, and educational reform, even if they are imperfect. On Dec. 12, Secretary of State Colin L. Powell is expected to make a major speech favoring a new U.S. push in these areas.

The challenge: promoting change without provoking an even greater anti-American backlash than is already taking shape in the Arab world. The Administration aims to do this by expanding nuts-and-bolts programs that operate below the radar screen. One example: Some 50 women activists from 14 Arab countries visited Washington to learn about campaigning and lobbying—skills that could increase the number of women in Arab governments.

The approach may not sound revolutionary. But combine small, concrete steps with larger forces at work in the region, and Washington's optimists think the Arab world will indeed change for the better. It took about 20 years for Asia's and Latin America's authoritarian states to evolve into more democratic systems. A swift change of regime in Iraq could speed up that process in the Middle East. Even if it doesn't, a slow transformation is better than nothing.

Crock covers foreign policy in Washington.

COMMENTARY

By Chester Dawson

FUEL CELLS: JAPAN'S CARMAKERS ARE FLOORING IT

What could Honda and Toyota be thinking? On Dec. 2 in Tokyo, they rolled out the world's first commercially available cars running on hydrogen fuel cells. Each one—Honda Motor Co.'s FCX and Toyota Motor Corp.'s FCHV—cost about \$1 million to build. The companies are still struggling to line up their first dozen lease customers, even at the giveaway fee of \$500 a month that Honda is charging in the U.S. And neither manufacturer expects to see a mass market in this decade. Says Hiroyuki Yoshino, Honda's soft-spoken president and chief executive: "My goal is to build one a month over the next two or three years."

Tokyo's fuel-cell initiative may seem misguided. But in fact, it has all the

hallmarks of a farsighted strategy and calls to mind Tokyo's blossoming success in hybrids. Americans are snapping up these fuel-efficient, environmentally friendly cars—in some cases just to say that the U.S. should wean itself from imported oil. Fuel cells could turn out to be a bigger, more important chapter in the same book.

Pricy and unproven as fuel-cell cars may be, the pioneers will earn bragging rights on one urgently important virtue: Instead of burning gas—with all the attendant environmental and geopolitical stigma—the engines in these cars convert hydrogen to electricity. All that leaves the tail pipe is a trickle of H₂O. What's more, unlike U.S. rivals, Toyota and Honda are in splendid financial form.

They can afford to gamble on futuristic technology to win the lead in the next generation of global automobiles.

Certainly there are hurdles, including the high cost of platinum, the catalyst that triggers the electricity-generating chemical reaction. But this isn't the first time the Japanese have faced such challenges. In the 1990s, Honda and Toyota produced the first commercial hybrid cars, with electric motors powering the vehicles at low speeds and a gasoline engine used at higher speeds for recharging the electric battery. In Detroit, hybrids were dismissed at first as an expensive publicity stunt. But since 1997, Toyota has sold about 120,000 of them, and analysts say the business will turn profitable next year. By 2005, Toyota expects to pump out 300,000 annually.

Ford Motor Co. is outsourcing its hybrid motor from a Toyota affiliate for a 2004 model SUV. Others may follow suit. And all of this could well be a harbinger. "Toyota is setting up a de facto global standard for hybrids, and the same thing can happen with fuel cells," says Koji Endo, an analyst at Credit Suisse First Boston in Tokyo.





Indeed, Toyota is adopting the same basic hybrid architecture for its fuel-cell vehicles. "There's a lot of spin-off," says Kiyotaka Hamajima, chief technician for the FCHV.

By sprinting past competitors, Toyota and Honda are clinching deals with the few buyers willing to consider these cars. That could give them a leg up as they expand production and drive down costs. Already, they've upstaged DaimlerChrysler, which hoped to be first to market with commercial fuel-cell cars next year.

Detroit, to its credit, is chasing the same technology, with backing from Washington. Ford expects to launch a fuel-cell compact in 2004. And General Motors Corp. has three different fuel-cell prototypes on the road-show cir-

HONDA vs. TOYOTA

Forget fossil fuels—these cars convert hydrogen to electricity. By getting a jump on new technology, Japan aims to catch the wave of the future

cuit. True, GM's first commercial models won't be ready until 2010—but that's a strategic decision, the company insists. "There's no way we could enter into a business proposition [now] because of the costs of the technology," says Larry Burns, GM's vice-president for research and development and its chief fuel-cell guru.

Honda's engineer in charge of fuel cells, Yozo Kami, admits it will take at

least 10 years to bring sticker prices down to \$100,000, the cost of today's most expensive gasoline cars. But both Honda and Toyota can afford the losses up front because they are flush with cash—the fruit of good, long-term bets leading to record sales.

Japan's early-bird strategy in fuel cells is its answer to a chicken-and-egg dilemma: People won't buy them until they're made for sale. Whether car buyers choose vehicles that run solely on hydrogen over comparably priced hybrids or gas engines won't be clear for a decade or more. But if they do, recent history suggests it is Honda or Toyota technology they will be driving home.

Dawson covers Japan's auto sector.

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STRATEGIES

THE NEW HP: HOW'S IT DOING?

Costs are down and profits are up at Hewlett-Packard. Now, CEO Fiorina must reignite sales growth

As Carleton S. Fiorina closed out a two-day schmoozefest with analysts on Dec. 4, she was all smiles. And why not? The Hewlett-Packard Co. CEO is making good on her promise to squeeze efficiencies from the \$21 billion acquisition of Compaq Computer Corp. She has moved faster than expected to slash the workforce—some 17,900 employees have been eliminated so far. By yearend 2003, she expects to finish shaving \$3 billion from HP's expenses, a full year ahead of plan. Net income rose in the fourth quarter to \$309 million from a loss of \$505 million a year earlier, beating Wall Street expectations by 9%. And despite the departure four weeks ago of HP President Michael D. Capellas, Wall Street is warming to the company and has boosted its shares to \$18, the highest level since June.

Now Fiorina's challenge, which could prove every bit as tough as the merger, is to drive growth. Here she has

her work cut out for her. To make good on her vision of transforming HP into a towering colossus of technology, she faces a host of tough choices, from imposing wrenching changes on HP's sales model to gunning the company's cost-cutting efforts into overdrive. On some of these issues, Michael Capellas was pushing for quicker action (sidebar). With his departure, Fiorina faces less in-house pressure to hurry. But fierce competition is likely to force her hand, pushing an out-of-breath HP to run even faster.

Seven months into the computer industry's biggest acquisition ever, competitors are gnawing away at HP's market share in personal computers and servers. HP's revenue for fiscal 2002 is down 11%, to \$72.3 billion. The decline is more than twice the 4.9% drop that Fiorina promised back in June. Here, HP trails its two chief rivals, IBM and Dell Computer. Analysts expect IBM to finish the year with a 2.5% decline, while Dell races ahead by 20%.

Despite the bigger-than-expected revenue falloff, Fiorina insists that HP is prepared for Act II. She can already point to strong sales growth in printers. Earlier this year, HP launched more than 50 new printer models for the con-

SEVEN MONTHS INTO FIORINA'S MERGER, RIVALS ARE GNAWING AWAY AT HP'S MARKET SHARE

sumer line, along with a slew for businesses. The result: Operating profit jumped 89% year over year in the fourth quarter on record revenues that climbed 18%, to \$5.6 billion. The division is running so smoothly that Fiorina has raised margin expectations for the new

WHY CAPELLAS FLEW THE COOP



QUICK EXIT

Investors barely shrugged when Michael D. Capellas quit as president of Hewlett-Packard Co. in November to take the helm at WorldCom Inc. And CEO Carleton S. Fiorina doesn't lament the loss of her No. 2, credited with a turnaround during his time as CEO at Compaq Computer Corp. "Frankly, his leaving is not an issue for this company, either short-term or long-term," says Fiorina.

What happened to the happy pair who fought to convince their investors that the deal to acquire Compaq was a sound move? Fiorina and Capellas insist there was no friction. "Carly and I have been through a lot together," says Capellas. "I would never have considered leaving if I didn't feel the company was headed in a positive direction."

But from the day the merger was completed, *BusinessWeek* has learned, the two clashed over the company's strategic direction and operational control. While the power struggle never broke out into open warfare, people close to the pair say Capellas became so frustrated that it hastened his exit.

Insiders say Fiorina maintained day-to-day control over operations. She had de-

partment heads, including Vyome who runs the printer unit, sidestep and report to her, say HP executives.

Within weeks of the merger's closing, Capellas was on the outside. While he had been billed as an operations ace who would stitch the two together, he was mostly a roving ambassador, reporting to investors and on the merger's progress. "Michael, president, not chief operating officer," says a senior HP exec. Capellas was only discuss some aspects of his role at HP. Fiorina, however, declined comment on any specific issues.

Capellas' biggest battle was over sales model. He argued that to boost profits long-term, HP needed to follow Compaq Corp.'s low-cost model



A WORK IN PROGRESS

Hewlett-Packard's printer business is sizzling, but other areas need fixing

ENTERPRISE SYSTEMS GROUP Servers, Storage, and Software

PROBLEM Revenue is down 13.8%, to \$7.8 billion, in the six months since the merger. Operating loss doubled, to \$574 million.

SOLUTION Began slashing 9,100 jobs, helping narrow losses by \$270 million in fourth quarter.

YET TO DO Must switch to Intel's unproven Itanium chip in the next 18 months and persuade customers to follow.

PERSONAL SYSTEMS GROUP PCs, Notebooks, Handhelds, and Workstations

PROBLEM Revenue is down 13%, to \$9 billion, since the merger. An operating loss of \$286 million.

SOLUTION Slashed inventory and cut 2,200 jobs, narrowing operating margin loss to 1.7%, vs. 7% a year ago.

YET TO DO Facing a surging Dell Computer, HP must move from resellers to direct sales. Only 23% of HP's commercial business today is direct.

from 11%-13% to 13%-15%. And printers now account for the bulk of its earnings.

To spark that kind of growth throughout HP, Fiorina plans to take on IBM. Her goal is to assemble HP's best arsenal, which includes everything

and selling computers to order. However, she favored fending off Dell for tweaks while continuing to use the company, which accounted for two-thirds of the company's revenues in fiscal 2002. On Nov. 11, the HP board heard presentations from Capellas and other HP execs—and Fiorina declared the go-slow approach.

Weeks later, Capellas took a call from Fiorina, the first in a series of tough discussions that led him to quit. Capellas left HP on Nov. 11, for a \$14 million buyout package that was included in his old Compaq contract. Fiorina announced he would not be rehired. Now, it's her show. Win or lose, she will trumpet that she did it her way.

Cliff Edwards in San Francisco, with Steve Hamm in New York

from printers and handheld computers to servers and storage, into package deals for corporate customers. She claims that HP, with its raft of technical partnerships, will give customers a broader choice of suppliers than IBM, which sells loads of its own wares. "We are going on the offensive," Fiorina declares.

The CEO is launching her blitz, however, with the gas tank only half-full. HP must convince big corporations that it is a powerful alternative. That may be hard, considering all the coughing and wheezing coming from HP's corporate computing business. The division of the company that makes high-end servers, storage devices, and software to manage corporate data centers remotely has lost \$574 million in the past six months. Fiorina insists all the laggard businesses will be profitable by the middle of next year, or face more pruning.

HP trails IBM in size and scope when it comes to such areas as service skills and software. What's more, HP is now facing a delicate balancing act: It must

keep customers from jumping ship as it phases out three proprietary server lines over the next two years to get behind Intel Corp.'s still-unproven Itanium chip. "They still have a lot of work to become a mover and shaker," says Goldman, Sachs & Co. analyst Laura Conigliaro.

Take the market for servers, which are typically run round the clock to tackle critical computing tasks. HP hopes to save hundreds of millions of dollars on developing its own high-end server chips by switching to Intel's Itanium chip. While Dell and others are likely to follow, Fiorina argues HP will have first-mover advantage.

And it will have a leg up in engineering, since it worked with Intel on the chip's development. But now, this HP division is moving in reverse. Researcher IDC says that, while in the three months ended in September HP accounted for 32% of the \$4.3 billion market for Intel-based servers, its revenue dropped 7%. Meanwhile, IBM, which tweaked its servers for better performance, boosted revenue by

22%. And Dell, offering low prices, saw sales rise 8%.

The Dell threat should not be taken lightly. The Texas computer maker announced plans on Dec. 9 to plunge into service offerings for small and midsize business customers. For as little as \$199, Dell says it will assess a customer's network and offer advice on setting up new servers, storage, and technical support.

And next year, Dell could be in a position to deliver a real body blow to HP. That's when the Round Rock (Tex.) company will begin selling printers and ink cartridges from Lexmark under the Dell label. It's all part of Dell's bid to take a bite out of HP's cash-cow printing business.

Fiorina swats away talk that Dell is HP's major competitor. Instead, she focuses on IBM. So far, she hasn't had much luck duplicating Big Blue's success. In a Merrill Lynch & Co. survey of corporate tech managers published

Fiorina swats away talk that Dell is HP's chief rival. Instead, she focuses on IBM

on Dec. 6, HP comes off badly in an increasingly vital market. Chief information officers say that HP's support for hardware and software based on open standards trails that of IBM and Dell.

The trouble is, customers will view HP as a printer and personal computer company—not a maker of powerful servers and services. Consider a deal it landed with Home Depot. In October, HP was awarded a contract to supply 40,000 Compaq Evo PCs. Not bad. IBM, however, walked away with the sweeter part of the agreement. Big Blue won a long-term contract for pricey servers, along with software to help Home Depot analyze data on sales, products, services, store performance, and customer buying patterns.

With technology spending expected to gain steam in the second half of next year, HP's rivals are positioned to race ahead. To make good on her ambitious goals for HP, Fiorina will have to race faster.

By Cliff Edwards in San Francisco

The Corporation

STRATEGIES

HALLIBURTON: HALFWAY HOME?

Dick Cheney's old company may be settling asbestos claims—as it wrestles with a business slump

Halliburton Co. has long been the kind of place where powerful people hung their hats, sometimes using their influence to help the oil-services giant in its quest for lucrative contracts. Its Brown & Root engineering unit was famous for flying Lyndon B. Johnson around Texas in its corporate planes. President George W. Bush's father, George H.W. Bush, once worked as an equipment clerk at Dresser Industries, which Halliburton bought in 1998. And, most famously, Dick Cheney filled the CEO job between gigs as Defense Secretary in Bush I and Vice-President in the current Bush Administration.

Lately all that political juice seemed to be of little help, however. Nasty headlines and angry shareholder suits thrust Halliburton into the controversy over corporate bookkeeping, as former Halliburton execs alleged that the Houston company cooked its books while Cheney was boss. The company says it did nothing wrong, but the allegations led to a Securities & Exchange Commission inquiry. Then there was a far more costly problem: an estimated 328,000 pending claims from workers exposed to asbestos.

Amid the gloom, Halliburton needed some good news—and now it appears tantalizingly close to getting it. As of Dec. 11, Halliburton was considering an offer from plaintiffs' lawyers that would have it pay \$4.2 billion to settle all outstanding asbestos claims and shield it from any future suits, according to Dallas attorney Peter Kraus, who represents plaintiffs who have sued Halliburton. "There are still substantial issues to be worked out," says

Kraus—including the ultimate value of the deal and the mixture of cash, stock, and insurance coverage that would be used to fund the settlement.

Halliburton is not out of the woods yet. It still faces the accounting questions, for one. And the company's basic business of providing sophisticated drilling services and equipment to Big Oil remains in the dumps. Through the first nine months of 2002, Halliburton lost \$382 million, vs. a \$670 million profit in 2001. Full-year losses are pegged at \$280 million compared with profit of \$809 million in 2001, on 6% lower sales of \$12.2 billion, says UBS Warburg analyst James H. Stone.



CEO LESAR

Still, an asbestos settlement would be a huge victory for CEO David J. Lesar. Following four costly judgments in asbestos suits last year earlier, Halliburton's credit rating was cut, and the company had to fend off rumors of imminent bankruptcy. Halliburton had aggressively fought asbestos lawsuits for years, even before inheriting more than 200,000 claims through its \$7.7 billion purchase of Dresser, which sold industrial equipment using the fire retardant insulation. But the fear of more outside jury verdicts appears to have driven the likely settlement.

To pay for it, Halliburton may have to discard one of its crown jewels, the engineering-and-construction unit now known as Kellogg Brown & Root (KBR), which built the Johnson Space Center in Houston for NASA and put out the Kuwaiti oil fires after the Gulf War. Kurt Hallead, an analyst at RBC Capital Markets, says that KBR could be restructured through a bankruptcy

A NOSE FOR NOTORIETY

Halliburton's big-time political muscle has always kept it out of controversy



WITH OIL PRICES LOW, HALLIBURTON HAS SCALED BACK SOME OFFSHORE BUSINESS

risky offshore oil and gas business. While such projects carry bragging rights, most are done on a fixed-cost basis. Overruns are Halliburton's responsibility. Added costs at an offshore oil field in Brazil cost the company \$119 million in the second quarter. Meanwhile, Halliburton is selling two offshore construction units, Halliburton Subsea and European Marine Contractors. All told, it expects asset sales to bring in \$500 million.

Also still hang-

ing and placed in a trust, with its proceeds helping to fund settlement costs over the next 15 to 20 years. Alternatively, KBR could be sold, with the proceeds used for the same purpose. True, KBR is in a bad shape right now. Demand has dried up for big oil-field developments, and annual sales, at \$5.2 billion, are 20% less than in 1998. But KBR should recover when the energy business snaps back. Analysts say it could contribute \$1 billion to a settlement trust.

Even before word trickled out of the settlement offer, investors were pushing the stock up—to about \$21, from a 52-week low of \$9 in July—on anticipation that the worst was over. "Asbestos was way overdone," says John K. Schneider, whose PIMCO Renaissance Fund owned 1.6 million shares this fall, even though it later sold some. Lesar, who is not available to talk to *BusinessWeek* for this article, clearly hopes the recent spate of Halliburton-bashing is coming to an end. "I've seen words like 'appropriate,' 'aggressive,' and 'fraudulent' in discussing Halliburton and its

management," he said in a July 24 conference call with analysts. "Get real."

But getting Halliburton back on track will take more than deft legal footwork. The problem: Oil services are hurting, the economy is in low gear, North American gas production is stalled, and some fear that oil could fall below \$20 per barrel. So there is little incentive for Halliburton's customers to buy drill bits or pumping gear to boost output. A war in Iraq could disrupt supplies—but analysts say this would not bring a frenzied search for new oil. Instead, existing sources, such as Russia, would just pump more.

Lesar's recovery plan calls for chopping costs, selling noncore assets, and moving away from fixed-cost contracts, which contributed to this year's losses. Lesar has reorganized the company's eight business lines into two units, Engineering & Construction and Energy Services, cutting 1,600 jobs. Along with other cost-saving measures, the company expects to save \$200 million a year. Halliburton is also retreating from

ing over Halliburton is the SEC probe. Halliburton made an accounting change in late 1998 that allowed it to book certain revenues before clients had actually paid up. But not until 2000 did it reveal to investors that it had counted \$132 million in such revenues. The company has said that such a small amount didn't need to be disclosed. Accounting experts disagree. But because there are no signs of fraud, they expect Halliburton to walk away with a slap on the wrist.

Halliburton still has political clout—it's just not clear how much. Lawrence S. Eagleburger, Secretary of State under the first Bush, is a director. And with a history of landing government contracts, KBR could prosper if the U.S. has to rebuild in a post-war Iraq. But with a legal victory apparently close, it now appears that any recovery depends as much on Lesar's management skills as on any favors it can wring out of Washington.

By Andrew Park in Dallas, with Lorraine Woellert in Washington

1997 A grand jury indicts Halliburton subsidiary Brown & Root, charging it with a rival on marine construction. B&R pays a \$1 million fine.

Halliburton pays out \$750 million to settle a lawsuit charging it with mismanagement in the construction of a Texas nuclear power plant.

1995 The U.S. fines Halliburton \$3.8 million for violating a ban on exports to Libya.

1999 A Halliburton subsidiary opens an office in Iran, despite the U.S. ban on doing business there.

2001 Shareholders criticize the company for its pipeline project in Burma, citing that country's human-rights abuses.

2001 Watchdog groups blast Cheney for basing 44 Halliburton subsidiaries in foreign tax havens.

2001 Plaintiffs in four asbestos cases win \$152 million.

2002 The SEC opens a probe of Halliburton's accounting.

Research by Susann Rutledge

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from other industries.

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Everything at once?

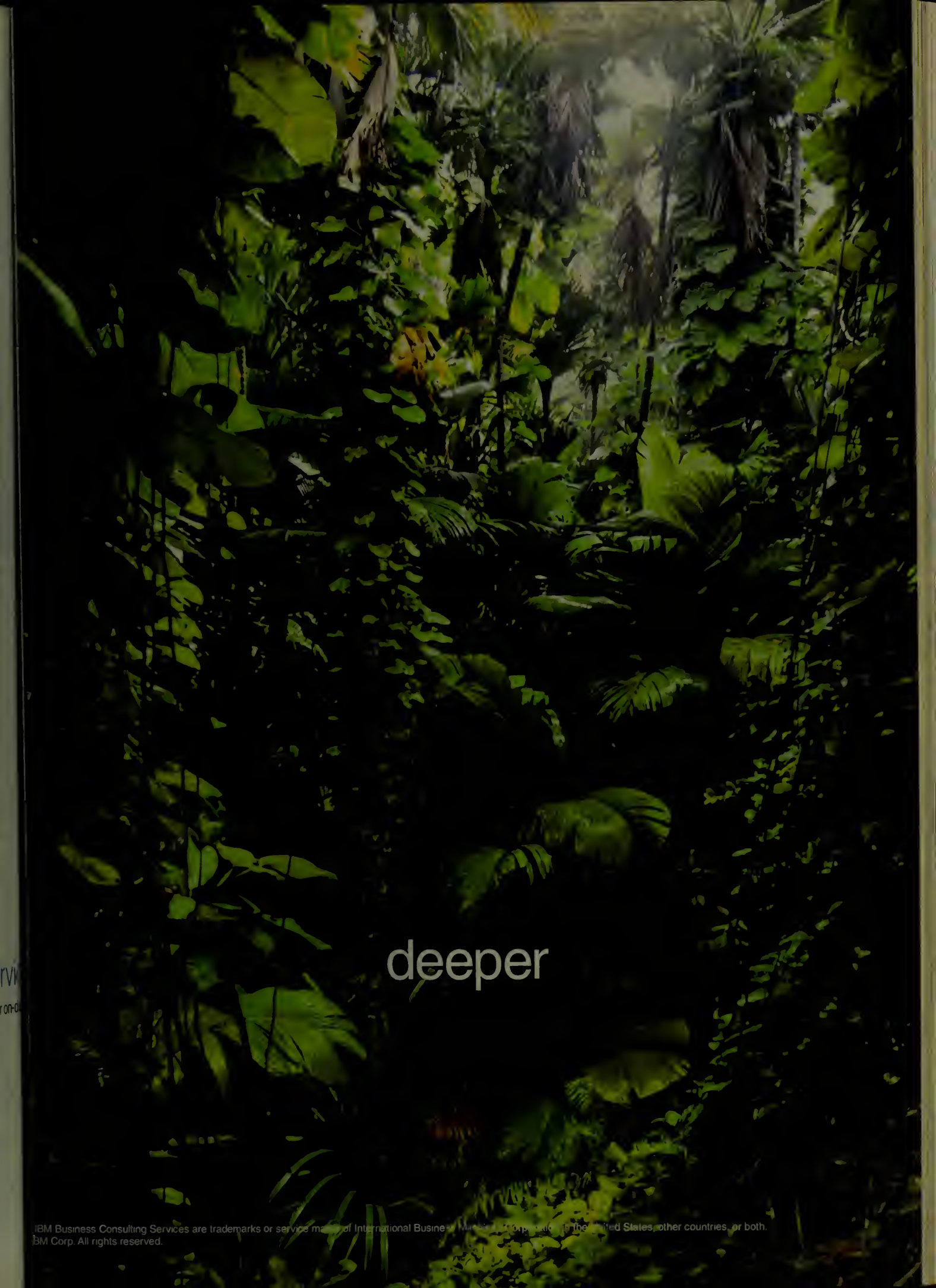
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WHAT ABOUT

Enron's auditors and bankers have been under the spotlight. Now, *BusinessWeek* reveals the attorneys' role

By Mike France

These are not happy days for Enron Corp.'s hired hands. The company's auditor, Arthur Andersen LLP, has been driven out of business. Its bankers, including Citigroup and J.P. Morgan Chase & Co., have been pilloried repeatedly, most recently in the Senate on Dec. 11.

But one group of professionals has so far escaped the inquisition: the energy giant's lawyers. They have been accused of no crimes, have paid no big fines, and are taking a hard line against critics. "There's nothing that I'm aware of that we would change," Joseph C. Dilg, managing partner of the Houston-based law firm Vinson & Elkins, told the House Energy & Commerce Committee in March. "We never saw anything at Enron that we considered illegal."

Are the lawyers as innocent as they claim? V&E and Enron's other outside law firms have taken far less heat than the company's accountants and bankers, but they played an equally

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important role in concocting the controversial transactions that allegedly concealed the company's true performance. Indeed, there's no way Enron's left hand could have sold so many assets to its right hand without creative input from both inside and outside counsel.

So far, this piece of the Enron drama has gone largely untold. But using recently released documents, as well as interviews with corporate insiders, *BusinessWeek* has assembled the most detailed picture yet of how attorneys assisted Enron's financial engineers. The lawyers not only drafted the documents that brought the company's deals to life but also wrote opinion letters that vouched for the legality of the company's acrobatic maneuvers—a little-understood piece of the puzzle that had to be completed before some of the deals could go ahead. By writing those opinion letters, attorneys blessed several transactions now being attacked as deceptive. "It takes a lot of little pieces of paper for an Enron to happen—and lawyers wrote a lot of those little pieces of paper," says Susan Koniak, a professor of legal ethics at Boston University School of Law, who is writing an analysis of the company's lawyers.

Enron is far from the only case in which lawyers helped executives accused of ripping off shareholders (table, page 60).



THE LAWYERS?



But while accountants will be answering to a new independent oversight board and investment banks are facing the involuntary restructuring of their research units, lawyers are looking at only some modest new regulations that the Securities & Exchange Commission is scheduled to implement in January. Many experts question whether the proposed reforms go far enough. "It is still part of the mythology of the profession that lawyers serve as brakes on bad conduct," says New York University School of Law legal ethics expert Stephen Gillers. "What we've seen in the past 20 years is that client pressures have turned them into more of a gas pedal."

Enron's attorneys insist that they violated none of their legal, ethical, or moral obligations. Whether they worked inside or outside the company, they all mount the same defenses: that the deals they worked on were legal, they had nothing to do with the company's accounting, and they didn't have enough facts to grasp the big picture at Enron. "If you are working on a deal, you don't always see the rest of the elephant," says V&E partner Harry M. Reasoner.

Ignorance may yet prove to be a legitimate excuse for many of Enron's lawyers, if only because, in its heyday, the company handed work to more than 100 firms and employed 250 in-house attorneys. The vast majority got nowhere near the deals Enron allegedly used to conceal its bad investments.

In fact *BusinessWeek* has learned that a fairly small group of lawyers handled the most controversial transactions at Enron. In-house, the key players were a few attorneys assigned to Enron Global Finance (EGF)—a legal team created to assist former Chief Financial Officer Andrew S. Fastow. The aggressive CFO seemed to think of EGF's top lawyer as "[his] attorney, rather than Enron's attorney," according to a summary of an interview with associate general counsel Rex R. Rogers conducted by the special investigative committee of Enron's board of directors. Fastow declined comment through his attorney, and Rogers did not return *BusinessWeek*'s phone calls.

Fastow rewarded favorite lawyers with juicy carrots. Former EGF general counsel Kristina Mordaunt invested \$5,800 in Fastow's LJM1 partnership and saw a return of more than \$1 million within months. Mordaunt's attorney did not respond to *BusinessWeek*'s calls. Lawyers Fastow disliked were clubbed with big sticks. According to several sources, he fired Mordaunt's successor, Scott M. Sefton, and attempted to sack EGF staff lawyer Joel N. Ephross because both resisted his direction. "Andy clearly surrounded himself with people he thought would be loyal to him and whom he could influence or pressure," says a high-ranking exec who participated in many of the deals. Sefton and Ephross declined to comment.

The outside firms that handled "the vast majority" of Enron's controversial off-balance-sheet transactions were V&E and Houston-based Andrews & Kurth (A&K), says a former Enron staff lawyer. They were frequently seated across the table from Kirkland & Ellis (K&E), a Chicago-based outfit that often represented the "independent" special-purpose entities (SPES) that bought Enron's assets. "Most of the heavy lifting was done by outside firms," says an Enron insider.

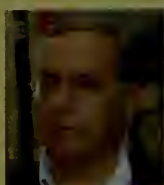
Andrews & Kurth declined to comment in detail on its work for Enron because of attorney-client privilege. "We

THE GOOD, THE BAD, AND THE INDICTED

Lawyers have their fingerprints all over the recent corporate crime wave. But an unsung few did speak out against questionable maneuvers.

THE CRIMINALLY CHARGED

Mark Belnick: The former Tyco International general counsel and Iran-contra prosecutor has been indicted by the Manhattan District Attorney for helping CEO Dennis Kozlowski defraud the company. He says he's innocent.



Belnick

Franklin Brown: Next year, the one-time chief counsel of drugstore chain Rite Aid is scheduled to defend himself against criminal charges of securities and accounting fraud. He has entered a plea of not guilty.



Brown

THE SUED

Vinson & Elkins: A shareholder-fraud class action in Houston accuses the firm that had the closest ties with Enron of helping execs cheat investors. V&E says it acted properly.



Signed off on many deals

Kirkland & Ellis: Also named in the Houston action. It represented many of the Special Purpose Entities that "bought" Enron assets. The firm says it's innocent.

THE APOLOGISTS

Simpson Thacher & Bartlett: Asked by Global Crossing last year to probe claims by a vice-president that the telecom was misleading investors, Simpson found nothing amiss—though it never even spoke to the exec. The firm says it did nothing wrong.

THE VIRTUOUS

Jordan Mintz: The midlevel in-house attorney tried to toughen procedures for approving Enron's related-party deals and sought advice on their legality from an independent outside law firm.

Stuart Zisman: Another midlevel counsel who spoke his mind. In September, 2000, he wrote a memo warning that some deals "might lead one to believe that the financial books at Enron are being manipulated."

Mintz being sworn in on Capitol Hill

know all our work for Enron was of the highest caliber and consistent with all of our professional obligations," said managing partner Howard Ayers. "We have just concluded this something we cannot talk about." K&E says it billed less than \$1 million on Enron transactions. "It is important to look at our firm's role," says K&E partner Laurence A. Urgenoso. "We were not responsible for any of Enron's accounting judgments or any of its disclosure judgments."

The main tools Enron allegedly used to manipulate its balance sheet were structured-finance deals—Rube Goldberg-like transactions cooked up by cross-disciplinary teams of lawyers, accountants, and investment bankers. The goal of these schemes, which are legitimately used by hundreds of companies, is usually to lower borrowing costs. This is done in simple terms, by transferring a reliable income-producing asset, such as rents, movie receipts or franchise fees, into a separate special-purpose entity (SPE). Because the SPE is isolated from the parent's credit risks, which might include everything from high debt to litigation exposure, it can borrow money at lower rates.

At Enron, these transactions were twisted to serve a novel goal, according to many public and private investigators who have scrutinized the company. The energy giant was less interested in borrowing money at low rates than it was in transferring underperforming investments to SPES—and thereby reaping the rewards of accounting rules that allowed these assets to be turned into cash and income without adding debt to Enron's balance sheet.

That, in turn, changed everything else about the deals. For one thing, the banks that put money into the SPE, thereby giving the entities their legal independence from Enron, did not look to the income stream generated from the SPES' assets for repayment. Instead, they allegedly counted on guarantees known as "total-return swaps," which were backed by Enron or one of its subsidiaries. The swaps generally provided that the energy giant would make all of the loan payments owed by the SPE to the banks—meaning that Enron was essentially buying assets from itself.

For corporate lawyers, structured finance is big game hunting. Fees for handling the deals typically run up to \$175,000—more than triple what the accountants earn. Attorneys first construct the SPE as an independent company, partnership, or trust with its own managers and complex operating rules. Then they'll build layers of corporate shells around it and execute a series of complex transactions among the various entities.

By definition, the attorneys had to know the terms of the deal inside out. Structured finance experts at Enron insiders say that it might be possible for a law firm to be called to handle one transaction and still be in the dark about its broader business rationale but that this comes less plausible the more deals a firm handles. "V&E saw a lot of these structured deals and they had to

ANATOMY OF A DEAL

A simplified view of one of the types of transactions Enron allegedly used to manipulate its balance sheet

Data: BusinessWeek

f the lawyers hadn't signed off with "true-sale opinions," many deals would have been stopped in their tracks

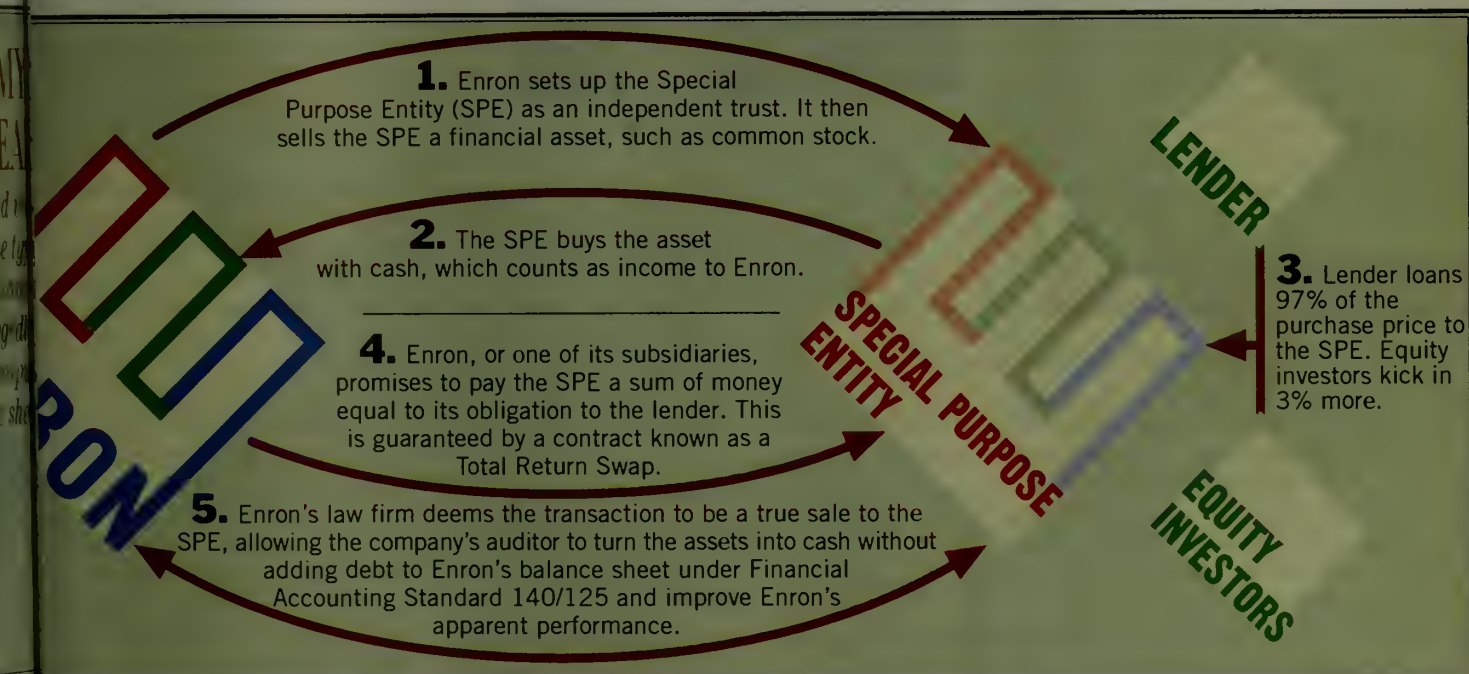
part enough to connect the dots," says one top executive at Enron. "V&E got nervous over time and started to push back. At the end of the game, V&E's role and share [of Enron legal work] was diminishing."

By far, the most sensitive task assigned to the attorneys was the writing of legal opinion letters. These are official memorandums expressing their view that a deal complies with particular facets of the law. Because opinion letters can be a source of liability, partners take them seriously. Before a deal gets issued, the firm completes a due diligence investigation, and a special partner committee generally has to approve the letter. Much like audited financial statements, they are signed by the firm rather than an individual partner—and they are written to make all parties comfortable with the deal. For instance, accountants rely on opinion letters when they are reviewing structured-finance deals involving common stock or other types of financial assets—which were quite pop-

like loans channeled from a bank through an SPE back to Enron (diagram). So the lawyers met with Arthur Andersen to discuss what the opinion letters should say. "V&E attorneys met with...Andersen auditors to ensure that V&E opinions would satisfy changing accounting standards involved in FAS 125 and 140," said a summary of the Ephross interview with the special committee.

When law firms have doubts about the legality of a particular transaction, they typically deal with it by writing hedged opinions. But that angers the accountants, who are required under FAS to obtain letters that meet certain minimum standards. As a result, there was frequently a tug of war about what the FAS 140/125 letters would say.

"The law firm might say to the deal team, 'Listen, under these circumstances, we cannot deliver a true-sale opinion. In order for us to deliver one, we need X, Y, and Z to happen,'" recalls an in-house attorney at Enron. "The accountants then



at Enron. Under Financial Accounting Standard 140 (and its predecessor FAS 125), auditors can approve off-balance-sheet treatment for these transactions only if they get opinion letters. Both are intended to assure SPE investors that the assets they are counting on to provide income will not be snatched away in the event that the sponsor of the deal—in this case, Enron—goes bankrupt. The first is known as a "true-sale" opinion, and the second is called a "nonconsolidation" opinion.

In November, 2001, Enron disclosed that FAS 140/125 transactions accounted for about \$2.087 billion in previously hidden debt. About 98% of these deals were handled by V&E and, according to an interview in-house attorney Ephross conducted with the board's special investigative committee, these firms have attempted to minimize their role in the Enron debacle, but the fact is that many of Enron's twenty-odd FAS 140/125 transactions wouldn't have happened if lawyers withheld true-sale and nonconsolidation opinions.

For the outside lawyers and Arthur Andersen, the opinion letters appear to have been a source of anxiety. The problem with the total-return swaps. They ran the risk of making the deals seem less like legitimate sales to an SPE and more

like loans channeled from a bank through an SPE back to Enron (diagram). So the lawyers met with Arthur Andersen to discuss what the opinion letters should say. "V&E attorneys met with...Andersen auditors to ensure that V&E opinions would satisfy changing accounting standards involved in FAS 125 and 140," said a summary of the Ephross interview with the special committee.

Both sides occasionally drew lines in the sand. "Andersen read some of the early letters Enron obtained in the Hawaii monetizations [a series of FAS 140 deals conducted in 2000 and 2001], was not comfortable with them, and asked Enron to obtain new ones," says the summary of an interview that the special committee conducted with Clint Walden, a high-ranking member of Enron's accounting team. Walden declined to comment.

Despite V&E's close relationship with Enron, it chose not to write opinions for some of the FAS 140/125 deals, according to both V&E partner Reasoner and Enron attorneys. In those instances, sources say, the company was able to get the letters from A&K instead. According to the summary of the special committee's interview with Ephross, Enron lawyers believed

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The lawyers "had to have a bag over their head not to see that there was something fishy going on," says an expert

that "it would be easier to get an opinion from A&K than V&E because A&K would raise less issues than V&E." He also said V&E was concerned that its opinion letters "were being improperly relied upon by Andersen." A&K's Ayers says it is "not aware of receiving any assignment from Enron that another law firm had declined."

Oddly enough, the players who seemed least interested in the opinion letters were those they were meant to benefit: the banks funding the SPES. According to a report issued by Neal Batson, the examiner appointed by federal bankruptcy court to review Enron's dealings, "Enron employees indicated that typically, these legal isolation opinions were more a matter of importance to Enron and to Andersen but were generally not a condition to closing the financing" with the banks. Because they had the reassurance

of the total return swaps, the banks felt secure. To Boston University legal ethics expert Koniak, that should have raised a big red flag. V&E and A&K "had to have a bag over their head not to see that there was something fishy going on here," says Koniak.

"The fact the buyer did not want a true-sale opinion is not

some subtlety. It is a blatant sign of possible fraud."

So just how vulnerable are the lawyers to liability? It's not clear. Like all professionals, lawyers face multiple layers of regulation—by their state bar associations, private lawsuits, and the federal government. So far, there's no hint of action on the self-regulatory front, though it's possible unannounced investigations may be underway.

Some attorneys have been named in private securities-fraud suits, however. Class-action lawyers have named both V&E and Kirkland & Ellis as defendants in the Enron case and are considering adding A&K and perhaps other firms to the list. But to squeeze any money out of corporate attorneys, tort lawyers are going to have to clear unusually high hurdles. In 1994, the U.S. Supreme Court held that outside professionals cannot be held accountable for "aiding and abetting" executives who commit fraud. Instead, they can be attacked only if they're deemed to be primary wrongdoers—a tough standard.

A bigger threat to Enron's attorneys is likely to be malpractice suits. The bankruptcy trustee, acting on behalf of the corporation, has the power to sue V&E and A&K for failing to steer the energy giant away from its disastrous deals. Bankruptcy Examiner Batson may have laid the groundwork in his interim report in October when he wrote that several of the SPE transactions "appear to be, from both an economic and risk-allo-



cation standpoint, a loan rather than sale of an asset." But a malpractice suit given all the complexities, wouldn't be slam dunk. The Enron bankruptcy "far exceeds any other case in history in professional fees," says a lawyer involved with the matter. "Someone is going to have to analyze whether it will be worth it to sue [the attorneys]."

All of this leaves a bit of a regulatory vacuum. That's one reason Congress gave lawyers new whistleblower responsibilities in the Sarbanes-Oxley law—which is now

being fleshed out and implemented by the SEC. The act requires attorneys who come across evidence of misconduct by a public company to report it "up the ladder" to top management, such as the general counsel or CEO. If there's no response, the lawyer must alert the board.

Sounds good in theory. But the Enron tale shows how unworkable it might prove in practice. Some Enron attorneys did speak up, but their worries were almost always dismissed. In September, 2000, in-house lawyer Stuart R. Zisman wrote a memo in which he warned that one of the SPE deals ran a high risk of being seen as balance-sheet manipulation. Close review of the transaction, Zisman wrote, "might lead one to believe that the financial books at Enron are being manipulated in order to eliminate the drag on earnings that would otherwise occur."

When he showed it to his supervisor, Mark E. Haedicke, he was told that "he had used unnecessary inflammatory language and editorialized too much in the memo," according to a summary of the interview Zisman gave to the special investigative committee. Haedicke declined to respond to *BusinessWeek's* request for comment. At the time, the new law would have compelled Zisman to take the matter to general counsel James Derrick or CEO Kenneth Lay. But it is difficult to imagine that many attorneys, after being shut out by their boss, would then bring their complaints to the top brass. And even if Zisman had done so, would anything have been different? Probably not, considering all of the other warning signs Enron's executive suite overlooked.

The SEC is considering dealing with this problem by requiring lawyers who can't get the board to take them seriously to contact the agency itself. If the American Bar Assn. and other professional organizations are fighting the provision tooth and nail. They argue that it will make clients less likely to trust their lawyers. Perhaps so. But given what happened at Enron, that may be a fair price to pay for restoring the public faith in the profession.

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WILL NEW RULES FORCE LAWYERS TO BLOW THE WHISTLE?

The Sarbanes-Oxley corporate-reform law requires lawyers to report wrongdoing.

The SEC is drafting the new regulations, to be released by the end of January. Among the proposed steps:

1 If attorneys find evidence of wrongdoing, they must alert top management.

2 If the problem is ignored, they must go to the board of directors.

3 If the board does nothing, they must tell the SEC. (Lawyers are lobbying strongly against this provision.)

Data: BusinessWeek

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A portrait of Dennis Kozlowski, a middle-aged man with a receding hairline, wearing a dark suit, white shirt, and a patterned tie. He is looking directly at the camera with a serious expression. The background is a solid blue color.

*The
Rise and
Fall of*

**DENNIS
KOZLOVSKI**

How did he become so unhinged by greed? A revealing look at the man behind the Tyco scandal

BY ANTHONY BIANCO,
WILLIAM SYMONDS,
AND NANETTE BYRNES

With every passing month, Tyco International Ltd.'s Leo Dennis Kozlowski looms larger as a rogue CEO for the ages. His \$6,000 shower curtain and vodka-spewing, full-size ice replica of Michelangelo's David will not be soon forgotten. At the office, too, Kozlowski's excess was legendary. He was the most prolific corporate acquirer ever, gobbling up 200 companies a year—nearly one every business day—at the height of his hyperactivity. If Wall Street saw Tyco's seventyfold increase in market cap under Kozlowski as proof of his genius, who was he to disagree? In 2001, Kozlowski proclaimed his desire to be remembered as the world's greatest business executive, as a "combination of what Jack Welch put together at GE...and Warren Buffett's very practical ideas on how you go about creating return for shareholders."

Kozlowski's claims to greatness were shredded this year by his indictment on two sets of charges brought by Manhattan District Attorney Robert M. Morgenthau. The first startled in the pettiness of the greed it exposed: A mogul worth at least \$500 million chisels New York City out of \$1 million in sales tax due on fine art. But the second indictment, handed down on Sept. 12, shocked in the scale of corruption alleged. In essence, prosecutors accused Kozlowski and former Chief Financial Officer Mark Swartz of running a criminal enterprise within Tyco's executive suite. The two were hit with 38 felony counts for pilfering \$170 million directly from the company and for pocketing an additional \$430 million through tainted sales of stock. "My client believes that the charges filed against him are unfounded and unfair," says Stephen Kaufman, Kozlowski's lawyer. Swartz also pleaded not guilty. Both Kozlowski, 56, and Swartz, 42, declined to be interviewed.

The story of Dennis Kozlowski's rise and fall—told here more completely than ever before—is a tragicomedy for our times. The history of American business contains few figures who were unhinged by greed as theatrically as was Tyco's burly ex-boss. But perhaps because Kozlowski is so apt a symbol of Bubble Era excess, the question of why he did what he did has gone unanswered and, in fact, has rarely been raised in print. In hopes of completing the unmasking begun by the twin indictments, *BusinessWeek* spent three months researching every aspect of Kozlowski's life. What emerges is a portrait of a man who was at once more admirable and more deceitful than the debauched Roman emperor of a CEO that the world has come to know and disdain.

For most of the 27 years that Kozlowski worked at Tyco, he was an exceptionally enterprising and effective manager. So what happened? "The bull market made me do it" is not a defense that will play in court, but the defects of judgment and character that brought Kozlowski down did not show themselves until the Great Bubble started

Cover Story

forming and CEOs were exalted as capitalism's 24-carat linchpins. Egged on by insatiably demanding investors, admiring analysts, and fee-hungry investment bankers, Kozlowski had become irrational exuberance personified by the late 1990s. The more he was paid in reward for Tyco's soaring stock price, the more he

Cover Story

spent on luxuries—and the more he allegedly stole.

In the end, Kozlowski's orgy of getting and spending even warped his business judgment. After two decades of sure-footed dealmaking, he closed out his tenure with a bizarre fandango of wrong-headed acquisitions and strategic U-turns that devastated Tyco's share price even before his first indictment. The \$90 billion drop in Tyco's stock this year exceeds Enron Corp.'s entire market value at its peak.

In an era of rampant financial trickery, Kozlowski's misdeeds were remarkable for their brazenness. It's not that Kozlowski, who trained as an auditor, wasn't a master of financial convolution; Tyco exploited every legal accounting loophole and tax-avoidance scheme imaginable after shifting its charter to Bermuda in 1997. Yet unlike Enron, WorldCom, Global Crossing, and other fallen idols of the day, Tyco has not been charged with fraudulent bookkeeping. It is entirely possible that investigators eventually will find that Kozlowski cooked the books with the worst of them, but the crimes of which he now stands accused are not a whole lot more complicated than taking bags of cash from an unlocked vault.

Where were the guards? DA Morgenthau will not discuss the Tyco case directly but implies that it reveals fundamental flaws in American business. In the past, corporate crooks tended to act on their own, Morgenthau says. "Now, you've got a lot of people involved, and that's the lawyers, accountants, executives, the board of directors. The whole system seems to have broken down." Add business regulators to Morgenthau's list. The Securities & Exchange Commission did not get around to investigating Tyco until early 2000 and did not find anything untoward when it did. The press, including *BusinessWeek*, also bears some blame for generally portraying Tyco as a lean and mean profit machine.

Kozlowski appeared on this magazine's cover for the first time in 2001, under the headline "The Most Aggressive CEO." A bruiser in pinstripes, "Koz" certainly looked the part: the CEO as middle linebacker. But it is apparent now that he was every bit as cunning as he was aggressive. Says a source close to Tyco's board: "Dennis doesn't come out and tell you how smart he is. He talks with you and gives you the feeling he is learning from you. That is



THE OPULENT DAYS

Kozlowski and Karen Lee Mayo, whom he married in 2000, lived royally in a \$16.8 million apartment on New York's Fifth Avenue (above); at sea on the \$15 million, 1930s-vintage yacht Endeavor (below); and in a \$29.8 million mansion they built in Boca Raton (below right).



the art of seduction. He's not an intimidator; he's a seducer.

There are not many native-born Americans who literally cannot go home again, but Dennis Kozlowski is one of them. The west-central Newark neighborhood in which he grew up in the 1950s and 1960s was demolished virtually in its entirety during and after the race riots of 1967. Where the two small apartment buildings that were home to the Kozlowski family—568 South 10th Street and 605 South 19th Street—once stood, all you will find now are weed-filled vacant lots.

Kozlowski has frequently described himself as the son of a Newark cop turned police detective. In writing about Tyco,



By the late '90s, Kozlowski personified irrational exuberance. The more he was paid, the more he spent—and the more he allegedly stole



name "Kid Kelly," and even rode with a polo team owned by tobacco heiress Doris Duke. But by the time that Dennis was born in 1946, Leo had taken full-time work as an investigator with Public Service Transport, a privately owned predecessor company to New Jersey Transit. Kozlowski did not tell people what he did for a living for fear that it would inhibit his ability to ferret out false accident claims brought against his employer, says his close friend Peter C. Pietrucha, a retired lawyer. "A lot of people who knew Leo did not know what he did," says Pietrucha, who provided Kozlowski with his cover, telling all who asked that Leo worked as his investigator.

According to Pietrucha, Public Service periodically loaned out Kozlowski to the FBI for special assignments, including the infamously violent 1968 Democratic national convention in Chicago. Leo also moonlighted as a prosecutor's detective—not in Newark, but in adjacent Bergen County—and "had a couple of bullets in him to prove it," Pietrucha says.

At the same time, Leo also had a second career as a kind of Newark ward heeler, delivering the Polish vote to Republican candidates. The longtime president of the Polish American Republican Club of New Jersey, Kozlowski was familiar to generations of GOP candidates for local and state office. "Leo was sort of a wheeler-dealer, I guess," says Stanley Grabowi, who knew Leo from the local "nest" of the Polish Falcons of America. (Kozlowski was the group's treasurer.) "He was not a guy to make speeches, but he did have a strong personality. When Leo was around, you knew it, let me put it that way." Not everyone took to Kozlowski, who was more arm-twister than charmer. "I remember him as a hard man, not a nice friendly person that you could talk to," says the Reverend Bogumil Chrusciel, the pastor at St. Stanislaus, a Catholic congregation that is still functioning in the Kozlowskis' old neighborhood.

The bottom line on Leo Kozlowski is that he was both a practiced deceiver and a public persuader—a dichotomy that also would come to define his CEO son, albeit in a much less benign way. "Leo was straight up and up," Pietrucha says.

"I'm surprised about Denny, but what can you do?"

Both Pietrucha and Grabowi say that Leo, who died in 1990, was hugely proud of his son's accomplishments in business. For his part, Dennis lauded his father in an interview with *BusinessWeek* in 2001 as a diligent provider "who worked his whole life until he retired at 65." However, he also mischaracterized Leo as a Newark cop.

The most striking thing about the young Dennis is how little he seemed to resemble his hard-nosed father, except physically. Friends from the neighborhood and from school remember him as an easygoing, even comical kid who did well in school without ever breaking a sweat. Elected "class politician" by his graduating class at West Side High in 1964,

this seemingly simple statement often has been used to not only that he sprang from humble circumstances also that he was home-schooled in an emphatic moral that right was right and wrong got you arrested. However, it turns out that Leo Kelly Kozlowski, Dennis' father, was a police officer in Newark or anywhere else. It was his mother, Agnes, who worked for the Newark Police Department—but as a school crossing guard. Journalism is not hoanalysis. But you don't have to put Dennis on the to conclude that the shadowy, even paradoxical figure of Kozlowski is the key to understanding his wayward son. second-generation Polish-American, Leo Kozlowski started as a reporter for the Associated Press, boxed under the

"Koz" seemed content to be one of the guys in college. Recalls one frat brother: "Dennis could be extremely funny and didn't mind if the joke was on him"



DENNIS KOZLOWSKI



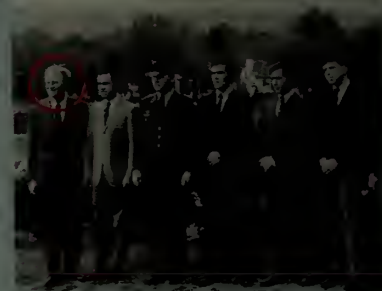
DENNIS L. KOZLOWSKI
Bachelor of Science Accounting



HUMBLE BEGINNINGS

In blue-collar—and racially charged—Newark, N.J., Kozlowski was popular with both black and white classmates. At Seton Hall, he joined two fraternities and worked his way through school.

DELTA SIGMA I



Kozlowski was as popular with his black classmates as his white ones. "Koz had a great heart," says Fred M. Dowling, who says it would have been dangerous for him to set foot in Kozlowski's neighborhood, and vice versa. "Tell him that he has friends from high school who've got his back."

Kozlowski went on to Seton Hall University, a Catholic school in South Orange, N.J. He continued living with his parents but paid his own

way through school by playing electric guitar in a band, among other

Cover Story

gigs. An accounting major, Kozlowski pulled down B's, joined two fraternities, and again seemed content to be one of the guys. "Dennis could be extremely funny and didn't mind if the joke was on him," recalls John J. O'Reilly, one of his Delta Sigma Delta frat brothers. "In fact, he laughed even harder when it was."

Many of Kozlowski's college buddies went straight from campus to Vietnam after graduating in 1968. Reserve Officer Training Corps was mandatory during the first two years at Seton Hall, but Kozlowski opted out as a junior and a search of military records indicates that he did not serve. Kozlowski, who had earned a single-engine pilot's license while attending college, has said that he moved to Arizona after college in a fruitless attempt to find work as a commercial pilot—an account that sounds incomplete at best.

In any event, in 1970 Kozlowski took an auditing job in New York City with the conglomerate SCM Corp. Within a few years, he had moved up to director of audit and analysis for Nashua Corp., a photocopier manufacturer based in the New Hampshire city of the same name. "He was a smart young guy who could really help a business," recalls William Conway, Nashua's former CEO. "Any problem that came up in the company—in administration, selling, manufacturing—he always had suggestions about how to fix it."

Kozlowski's latent ambition really began to kick in in 1975, after a headhunter invited him to come down to Waltham, Mass., and meet Joseph Gaziano. The chairman and CEO of

Tyco Laboratories was a jumbo-size, profane Massachusetts Institute of Technology-educated engineer who exaggerated the ferocity of his appearance by shaving his head weekly. Gaziano also had a taste for the high life, with a prize collection of perks including a jet, a helicopter, and three luxury apartments. Kozlowski was entranced. "He was very engaging," he recalled in a 2001 interview. "So I signed up for what I thought would be a year or two."

But by 1977, Kozlowski was so keen to advance at Tyco that he started taking night classes at Rivier College, a Catholic college in Nashua. He completed only three classes though he claimed to have earned an MBA from Rivier in a questionnaire submitted for the 1988-89 edition of *W*

TAX TRICKS

By fiscal 2001, Tyco was saving over \$600 million a year in income taxes thanks to one of the most aggressive tax strategies ever by a multinational to avoid paying U.S. taxes. Before moving to Bermuda in 1997, 35% of its income was going to pay taxes. By the end of the Kozlowski era, that had been sliced to 18.5%. In an interview with *BusinessWeek* last year, then-Tyco CFO Mark Swartz bragged that Tyco's ability to avoid taxes "has been a huge strategic advantage."

HOW KOZLOWSKI DID IT:

► **MOVED OFFSHORE** to the tax haven of Bermuda to complete a reverse merger with ADT Ltd. in 1997. This put all of Tyco's income beyond the reach of the Internal Revenue Service.

► **SET UP A FINANCE SUBSIDIARY** in Luxembourg as Tyco International Group (TIG). TIG helped finance Tyco's debt by borrowing billions and reloaning the money to units in the U.S. and other high-tax jurisdictions. The interest that Tyco's U.S. units pay on these loans is not taxed in Luxembourg and is tax-deductible in the U.S.—thus cutting



CORPORATE APPRENTICESHIP

Kozlowski, who went to work at Tyco in 1975, managed to thrive under two very different CEOs: First Joseph Gaziano (top left), a brash MIT-trained engineer with a taste for acquisitions—and the high life; then, after Gaziano's death, John Fort (bottom left), a reserved New Englander who shifted the focus from growth to profits. In 1985, with his star ever rising, he moved from Sudbury, Mass., (top right) to tony North Hampton, N. H. Later, a \$6 million Nantucket manse (bottom right) would be one of several houses.



in America—an inconsequential but prophetic deception. Founded in 1960 as a scientific research lab, Tyco had transformed itself into a high-flying conglomerate in the 1980s by acquiring two dozen companies of all sorts. Most of the lemons among them had been divested by 1973, when Gaziano's hiring initiated a second bout of deal mania. The conglomerate structure had fallen into disfavor, but Gaziano turned to be the next Harold Geneen, the mastermind of the conglomerate ITT Industries Inc. Gaziano pulled off a dozen big acquisitions in his decade as CEO but sabotaged his own grand ambitions by launching hostile takeover bids on too many well-defended companies. In 1982, Gaziano succumbed to cancer of the heart. He was just 47.

liabilities. By 2001, Tyco had \$16.7 billion in such company loans outstanding.

OVER 100 SUBSIDIARIES with names like "Bod" and "Bunga Berabu" in such tax havens as the Cayman Islands, Barbados, and Jersey. They are perfect vehicle for shielding interest, dividends, royalties, and other forms of income from tax, says Samuel C. Thompson Jr., a professor at the University of Miami School of Law. The subsidiaries are part of the reason Tyco was able to report in 2001 that 65% of its revenues came from the U.S., only 29% came from overseas.

Now that Kozlowski is gone, Tyco is scaling back its use of tax tricks. On Sept. 25, Kozlowski's replacement as CEO, Richard Breen, said a reexamination of its financials had led him to raise Tyco's estimate of its effective tax rate for the year ending September, 2002, to 22%, from 18.5%. Later, he said it would climb into the high 20s in 2003. Some analysts believe Tyco may be forced to move back to the U.S. because of the drive to leave its problems behind.

Gaziano was replaced by 41-year-old John F. Fort III, who also had an MIT degree but was Gaziano's opposite in every other way. A coolly analytical, abstemious New Englander, Fort rationalized the heaping pile of assets that Gaziano had haphazardly acquired, shifting Tyco's focus from growth to profits. "The reason we were put on earth is to increase earnings per share," Fort declared, to Wall Street's delight. The new CEO grounded Gaziano's air force and flew coach. At Fort's Tyco, even company cars and country club memberships were taboo.

That Kozlowski thrived under both Gaziano and Fort was a testament not only to the breadth of his talents but to his eagerness to succeed. "Gaz" was a seminal influence on Koz, who admired and to some extent emulated the older man's daring and defiant individuality. As a CEO himself, Kozlowski would share Gaziano's mergers-and-acquisitions obsession, though not his self-defeating predilection for hostile deals. Under Fort, Kozlowski transformed himself from number-crunching staff man to crack operating executive, implementing the new CEO's profits-first agenda with a vengeance.

Kozlowski made his mark as president of Tyco's largest division, Grinnell Fire Protection Systems Co. In short order, Kozlowski cut overhead to the bone, did away with 98% of the written reports required by his predecessors, and remade Grinnell's compensation system. Salaries were set low, but now each manager could earn a bonus pegged to the earnings of his profit center. He could also be fired. To emphasize the stakes, Kozlowski held a banquet at which he presented awards not only to the best warehouse manager but also to the worst one. "It was kind of embarrassing watching a guy go up," says R. Jerry Conklin, a former Grinnell executive. "It was like his death sentence."

Over the course of the 1980s, the last remnants of happy-go-lucky Koz of West Side High and Seton Hall vanished, just like the old neighborhood in Newark. As Kozlowski climbed the ladder at Tyco, what might be termed the inner Leo increasingly emerged. He now was a corporate tough guy, respected and feared in roughly equal measure.

In 1985, Kozlowski moved with his wife of 14 years, the



Way back in the late nineteenth century, Jules Verne, that master of science fiction, foresaw many of the technological wonders that are commonplace today. Everything from the submarine, to the airplane, to rocket travel in outer space. He also predicted that we'd have TV in another thousand years.

Yet, as far-reaching as Verne's imagination

was, even he would be somewhat astonished at the many marvels there are to be found in the Lexus ES 300.

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THE FALL

Manhattan District Attorney Morgenthau (top left) first indicted Kozlowski (right, at a Manhattan bail hearing) on charges that the executive had conspired to avoid paying \$1 million in New York City sales taxes on art purchases. Later he accused Kozlowski and ex-Tyco Chief Financial Officer Swartz (bottom left) of pilfering \$170 million directly from Tyco and pocketing an additional \$430 million in tainted stock sales



view, Tyco had merely hit a few nasty speed bumps on the road to greater glory. However, Fort wanted to brake the Tyco dream express and play it safe. A rift opened between Tyco's CEO and its most talented executive. Kozlowski, then 45, made threats, delivered no ultimatum. He didn't have to. He simply made certain that every director understood that he had ambitious plans for Tyco. "It was clear that you couldn't go on with two heads who were not really in sync," says a source close to the board. "So the board made a decision.... Needless to say, Fort was not pleased." But Kozlowski proved himself an adroit political operator, maintaining Fort as an important ally even as he took his leave from him. The 51-year-old Fort resigned as CEO in mid-1992 and as chairman a few months later but agreed to remain on the board, lending credibility to Tyco's spinning of his ouster as a triumph of succession planning. Remarkably, Fort would remain a director over the

former Angeles Suarez, and two young daughters into a \$900,000 colonial-style house in North Hampton, a sylvan old-money enclave on the New Hampshire Seacoast. The Seacoast is an insular, show-me sort of place, but the Kozlowskis were quickly accepted. "They were a real pleasure to deal with," recalls Chris Moutis, a restaurant owner who has known the Kozlowskis since the mid-1980s, when he waited on them regularly. "Angie was Laura Petrie [of *The Dick Van Dyke Show* fame] come to life—a lovely, lovely woman."

Even as Kozlowski was out-Forting Fort as an operator, he began rebuilding the Tyco deal machine. Fire control was a mature, cyclical business,

Cover Story

but Kozlowski transformed Grinnell into a fast-growth company by buying out its competitors one by one. Fort and Joshua Berman, Tyco's outside counsel and longtime board member, were importantly involved in negotiations, but Kozlowski "was the person who got the deals executed," recalls Robert A.G. Monks, a Tyco director from 1983 to 1994. "It was very clear these deals were value-adding.... What was startling was the speed with which acquisitions were integrated into Tyco."

Fort put Kozlowski on Tyco's board in 1987 and promoted him to president and chief operating officer two years later. In 1990, Tyco made its biggest acquisition yet, paying \$360 million for Wormald International, a global fire-protection concern based in Australia. Wormald proved something less than the prize it had seemed, and Tyco's dependence on nonresidential construction hurt it badly during the recession of 1991.

Oddly, this rare stumble set Kozlowski up for a power play that landed him in the corner office. In Kozlowski's

10 tumultuous years, implicitly endorsing by his continued presence Kozlowski's increasingly radical departures from Tyco tradition.

Kozlowski's ascension to the top job at Tyco coincided with the breakdown of his marriage, which appears to have been no less a turning point in his gradual transformation from regular guy to free-spending Master of the Universe. The Kozlowskis would not divorce until 2000, but they separated some time in the early 1990s, after Dennis took up with Karen Lee Mayo, a statuesque waitress who looks a bit like the actress Kim Basinger. Kozlowski met Mayo at the Beach House, a first-rate restaurant in North Hampton, in her early 30s, was married, too—to Richard Locke, a lobsterman from an old, well-known Seacoast family. Locke had his suspicions but no proof until Karen and Kozlowski spotted holding hands during a U.S. Open telecast from New York.

After leaving Locke for Kozlowski, Mayo quit waitress work, acquired a beach condo and a personal trainer (who later went to work for Tyco), and began spending lots of money in Portsmouth's finest shops. Whether by choice or necessity, Kozlowski and his new paramour kept a low profile. "I never once saw them at a benefit or a restaurant opening, which is a big deal here," says one socially prominent Seacoast resident. "In fact, I never saw them anywhere."

By the time that Kozlowski and Mayo married in 1992, they had all but left the Granite State behind, preferring to divide their time among palatial homes in Boca Raton, New Tuckert, Beaver Creek, Colo., and New York City, where Kozlowskis made a short-lived foray into high society. "They might have had a social presence someday at the rate they were going, but they weren't especially good at it," says David Patrick Columbia, editor of the New York Social D

Web site. "I mean, they bought all this art, but it was bad art. They got greedy: They wanted to do it all right away."

Kozlowski stepped up to CEO with a keen understanding of Tyco's basic weakness and a plan for fixing it. By now, Tyco was a \$3.1 billion company organized into four divisions: fire protection (53% of revenues); valves, pipes, and other "flow control" products (23%); electrical and electronic components (13%); and packaging materials (11%). However, this appearance of diversity was an illusion; a staggering 80% of Tyco's revenues came from the notoriously volatile commercial construction industry. Kozlowski set out to reduce Tyco's reliance on construction and accelerate its growth by acquiring companies in non-cyclical businesses.

In 1994, Kozlowski broke decisively with the conservatism of the Fort era by proposing that Tyco lay out nearly \$1 billion to acquire Kendall International Inc. A 90-year-old maker of disposable medical supplies, Kendall hardly fit the profile of a growth company. Just two years removed from Chapter 11 bankruptcy, its sales were rising at a tepid 3% to 4% a year. But demand for medical supplies was robust, and Kozlowski believed that he could whip Kendall into shape. Even after Tyco's board had reluctantly assented, Kozlowski still had to persuade many of its largest investors to give him the benefit of the doubt. "I got beat up unmercifully. So I rented a house on Nantucket and spent my summer flying around to meet with shareholders," recalled Kozlowski, whose powers of persuasion again proved equal to the task.

The CEO had taken a career-making gamble and hit the

Prosecutors say Kozlowski set up a generous relocation plan for himself and some members of his inner circle in 1995— and never notified Tyco's directors

jackpot. Kendall formed the nucleus of Tyco Healthcare Group, which would grow through acquisitions of its own to become America's second-largest producer of medical devices, behind only Johnson & Johnson. The addition of Kendall alone caused Tyco's earnings to nearly double in 1995, to \$214 million. The board rewarded Kozlowski with a hefty raise to \$2.1 million and also awarded him a big block of shares under a new restricted-stock-ownership plan. This scheme raised the bar on Tyco's compensation well above past standards, but Fort voted for it, as did every director.

Not long after the Kendall deal closed, Kozlowski promoted Mark Swartz to chief financial officer. As director of mergers and acquisitions, Swartz had played a key role in the transaction, turning around a key report analyzing its intricacies in less than 24 hours. Swartz, then 35, had joined

Tyco in 1991 from Deloitte & Touche. Like Kozlowski, he was an auditor who had risen rapidly without benefit of an Ivy League degree or an MBA. Swartz not only was financially astute but more polished and analyst-friendly than Kozlowski, who happily relied on his CFO to take the lead in romancing Wall Street. All in all, Swartz developed an extraordinarily close working relationship with Kozlowski that established him without question as Tyco's second-most-powerful executive.

In mid-1995, shortly after elevating Swartz to CFO, Kozlowski persuaded his board to let him move Tyco's headquarters from Exeter, N.H., to Manhattan. High atop 7 W. 57th St., Tyco occupied offices that were lavish even by high-roller standards, with spectacular views of Central Park. But because Tyco did not publicize its new address, Koz was able to continue to promote the company's humble hunting

BENDING THE NUMBERS

As a manipulator of accounting convention, Dennis Kozlowski, an auditor by training, has long been called a master. There was no rule, it seemed, that he could not find a way to bend—and because he did hundreds of deals, maneuvers that would have been of limited effect at another company had a major impact at Tyco. Although by other measures of efficiency, such as average sales per employee, Tyco curiously lagged way behind, the company enjoyed pretax profit margins of 22% at the height of the Kozlowski era, higher than those of General Electric Co.

not reduce earnings. The benefits, however, such as the higher operating margins that would result from getting rid of people and plants, flowed directly to the bottom line.

Tyco moved extraordinarily quickly to restructure acquisitions, ensuring it could get the favorable treatment and giving a big boost to profits in the process. Albert Meyer, a forensic accountant in Plano, Tex., who first questioned Tyco's accounting in 1999, calculates that in 2000 and 2001, Tyco booked \$544 million and \$894 million, respectively, as purchase accounting liabilities and that, all told, the maneuver kept some \$2 billion of expenses off the earnings statement.

► **"IMMATERIAL" ACQUISITIONS AND PLENTY OF THEM** Under generally accepted accounting principles, companies face no obligation to report acquisitions if they are small enough to be deemed "immaterial." From 1999 through 2001, Tyco spent \$8 billion on more than 700 acquisitions that it said were not material. But taken as a group, these 700 deals clearly had a huge impact on Tyco's results.

In each, Tyco may well have been taking steps to boost its numbers similar to those taken at its largest, disclosed deals, such as writing down the value of inventory and taking write-offs prior to closure. And since the transactions were never broken out, investors had no way of evaluating the quality of the earnings the acquisitions generated.

HOW DID HE DO IT? AT LEAST IN PART, THROUGH THESE ACCOUNTING MOVES:

► **LOADING UP ON GOODWILL** Because it assigned an exceptionally low value to most of the assets it acquired, Tyco now has a staggering \$26 billion worth of goodwill on its balance sheet. (Goodwill is the premium an acquirer pays over the fair market value of the net assets acquired.) That helps boost both earnings and cash flow because it enables the acquirer to book additional revenue free of most of the costs of the acquisition.

► **PURCHASING ACCOUNTING LIABILITIES** Under accounting rules, Tyco was allowed to classify the cost of "restructuring" companies it bought as an assumed liability. That meant that charges for laying off workers and closing plants went on the balance sheet and did

lodge of a building on the outskirts of Exeter as a symbol of its thrift. "We don't believe in perks, not even executive parking spots," he bragged in 2001 as he squired one visitor around Exeter, long since downgraded to a backup role.

Cover Story

This was only half a lie. Even as Kozlowski was piling on the plush at headquarters, he set earnings goals for Tyco's operating divisions that forced them to pinch pennies. This double standard—and Tyco's strictly-by-the-numbers management—tended to antagonize the top executives of acquired companies, most of which Tyco radically shrank to boost cash flow immediately. "I think they didn't grasp the human capital issue," says Richard V. Snyder, a former executive of electronics giant AMP, which Tyco would buy for \$11.3 billion in the late 1990s. Tyco "immediately gets rid of anything that it feels is not revenue-producing. It's like it buys [a company], strips out the loin, and jettisons everything else."

It was the shift of Tyco's headquarters that appears to have prompted Kozlowski to begin lining his own pocket, albeit quite modestly at first. At the CEO's urging, the board approved a standard relocation plan to move employees to New York. According to prosecutors, Kozlowski worked with several key lieutenants to set up a second, more generous subsidy scheme for themselves. Tyco's human-resources department helped Kozlowski implement the plan, which allegedly was kept secret from the board.

The additional cost to Tyco was negligible—at least until Kozlowski and his cronies began buying and furnishing expensive Upper East Side apartments on the corporate dime—but Kozlowski had nudged open a Pandora's box. With the \$6 billion acquisition of ADT Security Services Inc. in 1997, he blew the lid right off the hinges.

Over the years, Kozlowski had often promised to put the CEOs of acquired companies on Tyco's board but had rarely delivered. Yet after acquiring ADT, he made room for three of its directors, including Lord Michael Ashcroft, its founder and CEO. An Englishman of great if studied charm, Ashcroft used his yacht, the Atlantic Goose, as a kind of traveling office. In his global pursuit of tax advantage, he set up ADT in Bermuda and became a naturalized citizen of Belize, even serving for a time as the tax haven's ambassador to the U.N.

Associating with a man of such bravado apparently inflamed Kozlowski's greed. He structured the acquisition as a reverse takeover, enabling Tyco to assume ADT's Bermuda registration as the first step in

creating a network of offshore subsidiaries to shelter foreign earnings from U.S. taxes (page 68). Kozlowski also put Ashcroft's two colleagues on Tyco's compensation committee, which had four members all told. Tyco promptly shed the last remnants of its Fort-era restraint as it retooled its compensation policies to emulate ADT's. The changes worked hugely to Kozlowski's benefit as Tyco's stock soared. His total compensation rose from \$8.8 million in 1997 to \$67 million in 1998 to \$170 million in 1999, ranking him second among all CEOs and far ahead of his idol, Jack Welch.

And why not? From 1997 through 2001, Tyco's revenue rose by 48.7% a year, five times faster than General Electric's while its pretax operating margins improved to 22.1%, easily topping GE's 16.4%. One could argue that Kozlowski deserves

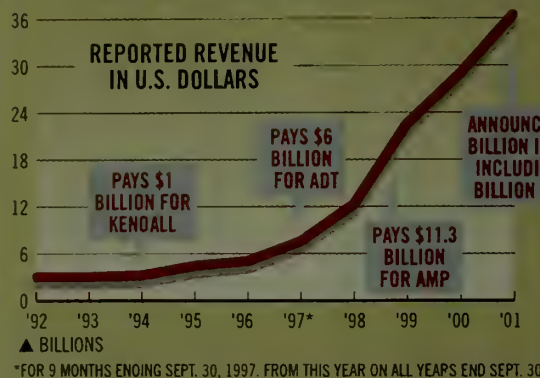
to make more than Welch. But it appears that Kozlowski took the argument one step further, convincing himself that he deserved more money than he himself was making. Abraham Zeleznik, a psychoanalyst and professor emeritus at Harvard Business School, suggests that Kozlowski was undone by a rampant sense of entitlement: "By entitlement I mean an aspect of a narcissistic personality which comes to believe that he and the institution are one" and thus "that he can take what he wants when he wants it."

According to the indictment, Kozlowski's thievery escalated markedly after Tyco shifted 40 more employees from Exeter to Boca Raton, where ADT had a swank office. Once again Tyco charges, Kozlowski set up an unauthorized relocation plan and also began abusing the company's Key Employee Loan Program, which had been established to help executives pay taxes due upon the vesting of restricted shares. From 1997 through 2001, the CEO allegedly used the loan program and the covert New York and Boca Raton relocation account like revolving credit lines, dipping into one or the other for hundreds of millions in interest-free funds.

Kozlowski laid out \$29.8 million to build a mansion in Boca and an additional \$30.8 million to buy and furnish an apartment on Fifth Avenue in Manhattan. He topped off his collection of airplanes and speedboats by shelling out \$15 million for Endeavor, a rare 1930s-vintage yacht. He spent upwards of \$20 million on fine art, including \$3.9 million on a middling Renoir that he pretended to ship to Tyco's office in New Hampshire, which has no sales tax. He gave Karen \$1.5 million to start a restaurant in Boca Raton, and on his 40th birthday party he threw for his new wife in 2001 on the Mediterranean island of Sardinia, cost \$2.1 million. According to Tyco, Kozlowski misappropriated \$43 million in corporate funds to make phil

THE KOZLOWSKI REIGN

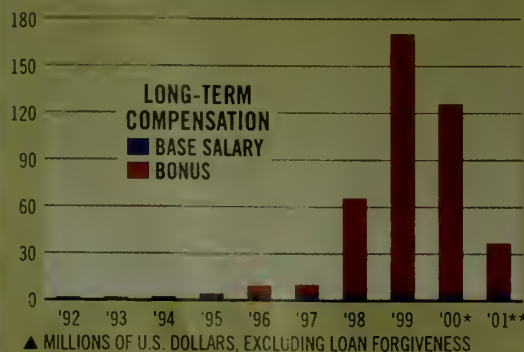
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...THE MORE THE STOCK ROSE...



...ADDING TO KOZLOWSKI'S RICHES



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anthropic contributions in his own name, including \$5 million to Seton Hall, which named its new business-school building Kozlowski Hall.

It's an old story, but still true: Money cannot buy happiness. Bob Monks, an outspoken admirer of Kozlowski's during his tenure on the Tyco board, was working in the little office that he maintains in South Florida in January, 2002, when Kozlowski called out of the blue and invited himself over. The

CEO spent a half hour with Monks discussing the latest unhappy developments at Tyco.

Cover Story

"He seemed very distraught," Monks recalls. "And he said he was very lonely."

Why didn't a whistleblower emerge from Tyco, as happened at Enron and WorldCom? For starters, Kozlowski had a talent for designing an undercover operation, just like dad. Tyco's highly centralized structure served to severely limit the people truly in the know. The company had more than 200,000 employees, but

pensation to the CEO's. According to Tyco, Belnick was paid a staggering \$20 million in 2000 and also dipped into the co New York relocation loan program for \$10 million to and renovate a home in Park City, Utah, for his wife and Belnick was indicted along with Kozlowski and Swartz charged only with falsifying business records. He has pleaded not guilty.

In December, 1999, the SEC began an investigation of Tyco's handling of some 120 acquisitions. The following summer, however, after an exhaustive yet narrowly focused probe, the agency sent a letter informing Tyco that it was not taking action. The SEC's terse statement hardly qualified as an endorsement, but Tyco encouraged this interpretation. This close call seems to have emboldened Kozlowski to a point of recklessness. Within months, he had forgiven some \$100 million in outstanding relocation loans, and for the first time he began publicly touting Tyco as the second coming of GE.

In 2001, Kozlowski took his emulation of GE to a ruinously extreme in acquiring CIT Group for an outlandish \$9.2 billion. The notion of buying CIT, the poor man's GE Capital, or

SPIN DECODER

As his reputation grew, Kozlowski often repeated the tenets he claimed were the basis of his success. They sounded great. Unfortunately, they seem to have been largely untrue.

SPIN

"If you build an elaborate headquarters, people are tempted to spend a lot of time there, and it [becomes] really unproductive."

—BusinessWeek interview, April, 2001, conducted in the 20-year-old, two-story wooden building on the outskirts of Exeter, N.H. (right), that Kozlowski claimed was its operational headquarters

REALITY

In 1995, Tyco moved its actual headquarters to New York, eventually occupying a plush suite of offices in a landmark Manhattan skyscraper. In 1997, as part of its merger with ADT, Kozlowski set up a



second headquarters operation, this time in Boca Raton, where the deluxe accommodations included a corporate chef.

SPIN

"Hopefully, we can become the next GE Electric."

—May, 2001, to BusinessWeek shortly after the CIT deal was announced, part of a five-year M&A plan to vault Tyco to \$10 billion in sales

REALITY

Last year, General Electric earned \$13.7 billion on \$126 billion in sales. In the fiscal year ended September, 2002, Tyco lost \$9.1 billion on \$10 billion in sales.

only about 400 worked at headquarters, and not many of them regularly interacted with Kozlowski. Sources close to the ongoing investigations suggest that not even Swartz was fully apprised of the CEO's machinations. "There were probably from 5 to 10 other people who knew that something was up," says one such source. "But the extent of their knowledge varied greatly." One of the most knowledgeable was Patricia A. Prue, Tyco's top-ranking human-resources manager. Prue has received immunity from prosecution, according to the *New York Times*.

Kozlowski also used Tyco's extraordinarily generous bonus system to co-opt many key executives at headquarters and in the field. In effect, he twice bought the loyalty of the most strategically positioned employees, cutting at least 50 of them in on his under-the-table largesse. It is not clear how many of them understood that their relocation perks and "special bonuses" may not have been approved by the board. But Mark Belnick, a respected New York lawyer whom Kozlowski lured to Tyco in 1998 to serve as general counsel, allegedly signed a secret employment contract tying his com-

pensation to Tyco board member Frank E. Walsh Jr., who was friendly with Albert R. Gamper Jr., CIT's CEO. Dipped into his seemingly bottomless slush fund yet again, Kozlowski paid Walsh, a fellow Seton Hall alum, a \$20 million fee for a deal that would prove a flat-out disaster. (Tyco would divest CIT in 2002, booking a total loss of about \$7 billion.)

Tyco's other directors did not learn of the payment to Walsh until Jan. 9 of this year—about six months after it was made—when Swartz mentioned it in a rough draft of a proxy statement. "Everything changed," says one well-placed source. The board suddenly was "confronted with the reality that, my God, this guy is doing things that we don't know about." When the board challenged him, Kozlowski claimed that he had made an innocent mistake—that at least had talked Walsh down from the \$40 million he had initially wanted. Walsh refused to give the money back and left the board. Tyco sued Walsh and brought in the lawyer David Boies and his firm to start turning over evidence. Walsh declined to comment.

On Jan. 16, Kozlowski called his directors to Boca Raton

discuss a desperate plan to boost Tyco's sinking share price by breaking the company into four parts. The directors doubted their doubts but gave their approval four days later at a board meeting in Bermuda. The plan "will release value," Kozlowski predicted with a touch of defiance in an announcement on Jan. 22. "We believe there is over a 50% uple compared to [Tyco's] current market value." But the hastily concocted plan both puzzled and alarmed investors, who feared that Tyco was running short of cash. Within a few weeks, CIT effectively had been frozen out of the commercial paper market, forcing it and Tyco to draw down more than \$13 billion in bank lines. By early March, Kozlowski "was a changed person," says one Tyco insider. "Normally, he is very decisive, but now he was like a deer caught in the headlights."

In April, investors were flummoxed again when Kozlowski performed yet another about-face. Tyco was going ahead with the CIT sale, but not the bust-up, he said, prompting more catcalls from the Street. "We now know that it was a mistake," he admitted in an abject letter to shareholders. "I take full responsibility." A majority of di-

more stock today
ve ever owned.
percent of my
are in Tyco, and
en adding to my
n"

essWeek interview, 1999

ITY

vski was secretly
lots of stock—\$280
n worth, according
Manhattan DA's
ment of Kozlowski.
filed by the SEC
millions of shares
old to Tyco.

etors now were convinced that Kozlowski had to go, but there was disagreement about when to act. By early May, Kozlowski could feel the noose tightening. Belnick had been notified of Morgenthau's rapidly advancing investigation into the sales-tax allegations. But in public, anyway, Kozlowski maintained a brave front. On May 9, at his request, he met with the editors of *BusinessWeek*, insisting that he would never resign as CEO. And on a snowy Saturday morning a week later, he delivered a commencement address at St. Anselm College, a small Catholic college in Manchester, N.H., to which Tyco had given \$1 million. "As you go forward in life...you will be confronted with questions every day that test your morals," Kozlowski said. "The questions will get tougher, and the consequences will come more severe. Think carefully, and for your sake, do the right thing, not the easy thing."

In the end, it was Morgenthau who forced the issue. On May 31, a Friday, Kozlowski told his board that he was not to be indicted. On Sunday, June 2, the board demanded their CEO's resignation. Kozlowski complied without a

SPIN

"We've been made out to be freewheeling jet-setters, playboys reliving our adolescent years.... For me, and for most CEOs, the irresponsible image really rankles"

—Kozlowski writing in *Directors & Boards* magazine, September, 1995

REALITY

According to Tyco, the following is just some of what Kozlowski took without permission:

■ \$61.7 million in inter-

est-free relocation loans taken out under programs not approved by Tyco's board. Kozlowski allegedly used them to finance an opulent lifestyle and to buy properties that had nothing to do with corporate relocation—including

Renoir: Kozlowski spent some \$20 million on fine art



In some ways, Kozlowski actually outdid Welch, his idol. Certainly, he transformed the third-rate conglomerate that he inherited to a greater degree than Welch changed GE, which was renowned as America's best-managed corporation long before "Neutron Jack" happened on the scene. But Kozlowski ended up betraying his own talent and the company to which he devoted almost his entire career. It has been a steep and humiliating descent for the man who once vowed to become the greatest CEO ever.

With David Polek in New York

a Park Avenue apartment he deeded to his ex-wife.

■ A \$25.6 million "bonus"—also not discussed with the board—on the sale of an automotive business.
■ \$241.3 million in loans from the Key Employee Loan Program that were not spent to help hang on to Tyco stock, which is what the program was designed for, but instead were used as a line of credit to help finance fine art and antiques, a yacht, and a Nantucket estate.

New York prison system, not a Club Fed. Even if he is acquitted, history's verdict will not be kind.

BusinessWeek online

For an interview with District Attorney Robert Morgenthau and related stories, go to the Dec. 23 issue online at www.businessweek.com

Once upon a time,
there was a company that was
stuck. Frustrated. They were working
in isolation. Unconnected. So, they bought an
Elixir of Business Knowledge. With just one gulp,
they'd get unstuck. With another sip, they'd know how to link
process to process. Guys who were once lost in the old ways, suddenly would know
how to streamline things. Get people and products together. There was nothing they
couldn't know. *On demand*. But, the liquid was past its shelf life and didn't work.

AND THAT'S WHEN THEY CALLED IBM.

In the *on demand* era, you must know how to connect every department and person
in the value chain. Know how to "sense and respond." These are the areas where
IBM Business Consulting Services is focusing its attention. They can analyze and
rebuild processes to unlock value. On budget. Without elixir. Visit ibm.com/ondemand



IBM

@business on demand

Once upon a time,
there was a company with a terrible
problem: their servers just kept crashing.
So they bought Magic Server Pixie Dust. Simply
sprinkle on the Pixie Dust, and crashed servers would
suddenly come back to life. Sprinkle it on regularly, and they'd
never go down. Servers would run themselves. Repair themselves. *On demand*.
People were stoked. They could devote more attention to their other business
problems. It seemed almost too good to be true. The truth is, it didn't exist.

AND THAT'S WHEN THEY CALLED IBM.

In the *on demand* era, servers will need to have the ability to repair crashes before
they happen. To also protect themselves and manage themselves in ways never before
imagined. This is the kind of autonomic, *on demand* technology IBM is building
for the new "always on" environment. Not Magic Pixie Dust. Visit **ibm.com/ondemand**



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@ business on demand

NEW YORK: WHY THE MATH IS SO SCARY

Bloomberg has a \$6.4 billion deficit—and little room to maneuver

When Michael R. Bloomberg took office as mayor of New York on Jan. 1, he aimed to work wonders on municipal government, just as he had in the business world. "We cannot raise taxes," he said in his inaugural address. "We will find another way."

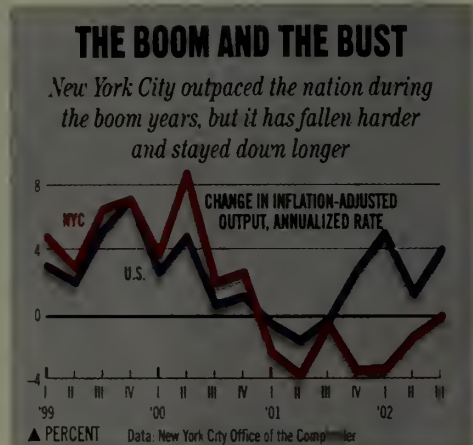
Bloomberg has already changed his tune; running New York in an economic slump has proved tougher than the self-made billionaire imagined. On Nov. 23, he pushed through an 18% property tax increase as an aggressive step to closing budget gaps projected at \$1.1 billion this fiscal year and \$6.4 billion in the year beginning next July.

It's not just because of the terrorist attack on the World Trade Center. Bloomberg has also been forced to confront two dismaying facts: First, New York's economy is more cyclical than the nation's because it depends heavily on Wall Street, whose profits are highly volatile. Second, New York has high fixed costs, including more debt per dollar of property value than any major city except long-suffering Philadelphia and perhaps Detroit. That combination—a cyclical economy and high fixed costs—virtually guarantees a fiscal crisis during an economic slowdown.

That's not to say the mayor and the city are helpless. In the long term, New York's priorities are obvious: chisel high costs from municipal government, pay down the debt, and rejuvenate the in-

frastructure—from streets to schools—to attract residents and businesses.

Right now, though, there's a budget crisis to contend with. The property tax increase should bring in an extra \$1.7 billion next year. Bloomberg also announced plans to seek a 2.7% levy on



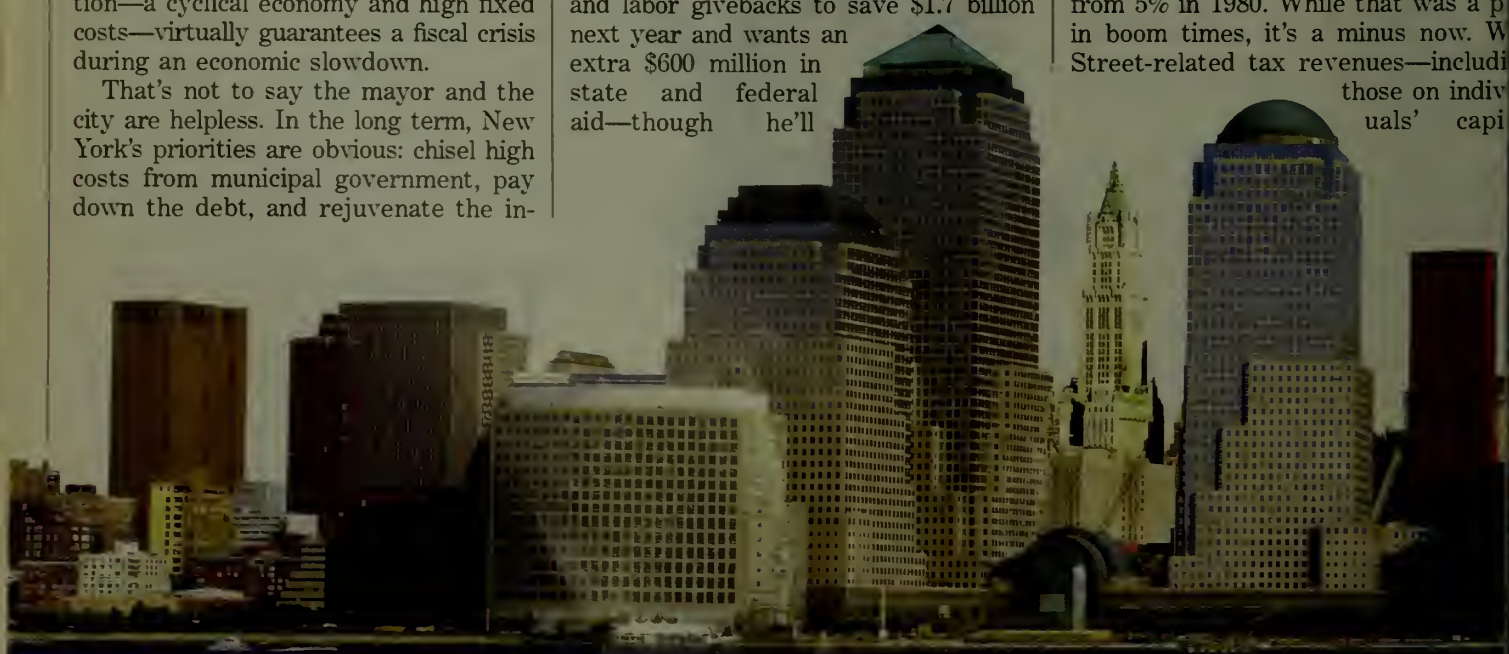
the incomes of suburban commuters—six times the size of the commuter tax that the New York state legislature repealed in 1999. He might get lawmakers to O.K. a 1% tax, which would raise close to \$400 million. He's also aiming for budget cuts and labor givebacks to save \$1.7 billion next year and wants an extra \$600 million in state and federal aid—though he'll

probably get only a fraction of the aid. Bloomberg's critics are howling that by emphasizing tax hikes, he's going down the wrong path. "There's a simple rule of thumb: You don't raise taxes in the middle of a recession," says Fred Siegel, a senior fellow at the Progressive Policy Institute, a centrist think tank.

Indeed, tax increases carry plenty of risks. Leo F. Wells III, president of Wells Real Estate Funds in Norcross, Ga., says property tax hikes could push him toward buying buildings across the Hudson River, in Jersey City, N.J., instead of in Manhattan. Says Wells: "People leave a lot quicker than they come back. You can kill yourself in the long run trying to take care of a short-term problem." The combination of increased taxes and improving communication could accelerate an exodus of brokerages and investment banks, says Andrew Johnson, head of Wall Street competition consulting firm Johnson Associates Inc. He predicts that "in the next few years, probably one of the big firms will move out of town."

What Bloomberg has run up against is an extreme version of the distress that's afflicting most mayors and governors in America. Unlike Washington, most state and local governments maintain separate budgets for operations and capital spending, and they're required by state laws to balance their operating budgets every year, even in slumps.

New York's problems are among the worst. In part, that's because of its dependence on the securities industry. With average pay of over \$200,000 a year, the finance sector supplies about 20% of personal income in the city, down from 5% in 1980. While that was a plus in boom times, it's a minus now. Wall Street-related tax revenues—including those on individual's capital



ins—are down 40% this year from their 2000 peak. Employment is back to 98 levels, a 10% decline, and falling. What makes the Wall Street downturn order to deal with is that almost two-thirds of New York's \$42 billion budget goes for involuntary expenses. The cost of servicing debt—which rose under Mayor Rudolph Giuliani, despite the prosperous times—represents a big chunk. The city has accumulated about \$5,000 in debt per person, which makes for an annual debt service bill of \$2.3 billion. Pensions account for another \$1.7 billion more, while welfare and Medicaid cost \$4.5 billion a year. An additional \$14 billion in spending on education, social services, and other functions is also considered non-discretionary, since it's tied with earmarked state and federal money. If the city is back on that spending, a portion of the earmarked funds gets taken away. That leaves only one-third of the budget, or \$15 billion, under the city's control. The bulk of that spending goes towards essential services like police, fire, sanitation, corrections, and locally funded education. The bottom line: It will be almost impossible to quickly close a budget gap of \$6.4 billion, through cuts in discretionary spending alone. Says William H. Cunningham, the mayor's chief spokesman: "I defy you to find any economist to make that math work." Over time, of course, diligent cost-cutters can make services cheaper to deliver. Bloomberg himself demonstrated his cost-cutting acumen at Bloomberg where he once sent carterers in on the weekend to trim the size of desks in

order to cram in more workers. But for New York City, the only way to cut costs instantly is through reducing services, and Bloomberg badly wants to avoid a repeat of the 1970s, a decade remembered for crime and dirty streets. The risks to quality of life were brought home in mid-December as the city braced for a possible illegal strike by 34,000 bus and subway workers employed by the Metropolitan Transit Authority—a state-operated agency that's also strapped.

With the slump continuing, Bloomberg's dilemma isn't going away anytime soon. His staff predicted last month that the city's inflation-adjusted output will

decline half a percent next year, on top of a 2.7% drop in 2001 and a projected 2.5% fall this year. Rae D. Rosen, senior economist at the Federal Reserve Bank of New York, warns that employment gains are likely to be concentrated in jobs such as restaurant and hospital work that generate less income tax than finance jobs. Says Rosen: "The fiscal picture is likely to remain difficult."

Still, there's much that the mayor can do besides plug holes in the budget. He can start by demonstrating his determination to attack spending. Local government jobs make up a fifth more of the local workforce in New York than in Philadelphia and about a third more than in Chicago. The business-funded Citizens Budget Commission estimates that New York's spending on police protection per capita is 46% above the big-city average. It recently proposed measures to save city agencies \$1.2 billion a year, from lengthening workweeks to rearranging police schedules to cutting energy bills.

As businesses threaten to leave town, Bloomberg shouldn't respond in desperation. Bribing companies to stay with big tax breaks only saddles others with higher taxes. These days, much of his time is devoted to crisis management. The billionaire entrepreneur must long for the days when all he had to do to trim costs was to pull out the saw.

By Peter Coy, with Steve Rosenbush and Emily Thornton, in New York

HOW TO BALANCE THE BUDGET

Mayor Bloomberg says that the city would face a \$6.4 billion budget gap in the year starting next July if nothing were done. Here's what he would do—and further cuts proposed by the Citizens Budget Commission. Still, the city may need more tax hikes and layoffs of police, firefighters, and teachers.



ACTION	BUDGET BENEFIT	LIKELIHOOD
RAISE PROPERTY TAXES 18%	\$1.7 billion	Accomplished
CUT SPENDING	\$1.7 billion	Likely
STATE-AUTHORIZED 2.75% COMMUTER TAX	\$1 billion	State might O.K. \$400 million
OTHER STATE AND FEDERAL AID	\$600 million	City might get \$200 million
CARRY OVER SURPLUS	\$600 million	Likely
REMAINING DEFICIT	\$700 million to \$2 billion	
CBC-RECOMMENDED CUTS*	\$1.2 billion	Might get \$200 million

*The Citizens Budget Commission recommends rearranging police shifts to cut overtime; putting more employees on 40-hour workweeks; improving procurement; and streamlining special education.



COMMENTARY

By Mara Der Hovanesian

WHEN BULLS GET THE HOOK, IT MAY BE TIME TO BUY

Near the end of 1997, Charles I. Clough Jr., Merrill Lynch & Co.'s then-chief investment strategist, forecast that the bull market would soon run out of steam. The 13-year Merrill veteran stuck to his guns as the market kept on rising. Two years later, Clough had left. And within two months, the market came a-tumblin' down. The boom was over.

Clough, who went on to form Boston's Clough Capital Partners LP, was one of a cohort of unheeded bearish strategists and economists on Wall Street who left their jobs in the months before the bull market tanked. Other departing prophets of doom included Salomon Brothers market strategist David Shulman, Oppenheimer chief strategist Michael Metz, and J.P. Morgan Chase chief strategist Douglas R. Cliggott.

Is this the Pink Slip Indicator? If so, there could be good news for investors, because now the indicator is flashing a signal that the stock market may be on the mend: These days, Wall Street is sending its bulls out to pasture. Big Picture strategists who failed to foresee that it would take at least three years to unwind the speculative excesses of the late 1990s are getting the boot.

Among the casualties are Credit Suisse First Boston's chief investment strategist, Thomas M. Galvin; Merrill Lynch's chief economist, Bruce Steinberg; and Lehman Brothers' chief market strategist, Jeffrey M. Applegate—respected strategists all. None has yet resurfaced in new posts. All said the bear market would be over by now. Applegate's targets for the Dow Jones industrial average have been off the

mark since 2001, when he predicted the index would hit 13,000 that year. Despite his expectations for a 10,000-plus Dow since then, the index has traded mostly below that mark.

The firms say the sackings are just the luck of the draw. The official

saying the market was overheated. His 12-month forecast calls for a 7% fall in the Standard & Poor's 500-stock index. Bernstein replaced Christine A. Callies, a bullish strategist, a year ago. Merrill also promoted the bearish David Rosenberg to replace Steinberg, Merrill's chief economist since 1997. CSFB's new chief investment officer, Paddy Jilek, who replaced Galvin, won't issue targets in the near future.

Eminent bulls who have hung on to their jobs clearly have been shushed. True to form, Goldman Sachs & Co.'s Abby Joseph Cohen, a star strategist during the 1990s boom, reiterated on Nov. 25 that equity prices would rise 20% over the next 12 months. She says institutional investors should put 75% of their assets in equities.

Bullish, to be sure, but a lot more subdued than on Oct. 9, when she predicted a 50% rise in stocks. Cohen's calls used to make the prime-time news; no longer. "Everybody is your friend when you make a forecast and the market moves your way," says Joseph V. Battipaglia, chief market strategist at Ryan Beck & Co., another veteran bull who expects stocks to double in 12 months. "Obviously we have not seen results in the last three years [by predicting a recovery]. But the market is reacting more to psychological and short-term factors than to structural issues."

According to Street lore, pessimism is deepest at the end of a bear market—just as unquenchable optimism marked the end of the bull run. With the new crew of strategists pushing unremitting gloom, things may indeed be looking up.

Der Hovanesian covers markets from New York.



line from Merrill and CSFB is that the strategists lost their jobs in companywide downsizings that had nothing to do with off-target predictions. "We're making small adjustments across all divisions," echoes a Lehman spokeswoman. But at Merrill, bearish forecasts now abound. On Dec. 5, Richard Bernstein—a renowned bear and the former director of quantitative research—cut his equities allocation to 45% from 50%,

THE PINK-SLIP INDICATOR

Just before the market bust of 2000, several Wall Street firms let go their most bearish chief market strategists and economists. Now, with the bear raging, the big bulls are being shown the door.

STRATEGIST/ECONOMIST	FIRM	LEFT
JEFFREY APPLGATE	Lehman Brothers	Nov. 2002
BRUCE STEINBERG	Merrill Lynch	Nov. 2002
TOM GALVIN	CSFB	Oct. 2002
CHRISTINE CALLIES	Merrill Lynch	Nov. 2001

Data: BusinessWeek



GULATION

ICK A FINE, NY FINE

nalties for research abuses
uld be all over the map

Banks and regulators are haggling hard over fines to settle charges that Wall Street analysts brazenly misled companies they considered poor investments to win their investment banking business. Regulators and prosecutors want banks to pay between \$75 million and \$500 million each, depending on how egregious their behavior was and the firm's size. Some banks hope they can get off paying just \$25 million. Where do these numbers come from? Why does the punishment fit the crime? Fair as it may seem to investors who are big, whatever the banks pay will be arbitrary. "There's no art or science to fining you fine someone," says Deborah Pineda, Washington State director of securities. "You put a number out for negotiation. We never want to cripple a bank. But we want to send a very strong message that this was unacceptable behavior."

The closest thing to logic in the bank fine seems to be what New York State Attorney General Eliot Spitzer calls the "Merrill Plus" method. That means using the benchmark Merrill Lynch & Co.'s \$100 million fine in a similar case issued in April. It's probably no coincidence that Merrill's fine matched what

Credit Suisse First Boston paid to settle Securities & Exchange Commission allegations of improprieties in hot initial public offerings—though Spitzer has never publicly called it his benchmark. Spitzer has said he aimed to hit Merrill hard enough that the public noticed without damaging the firm.

In any case, based on the Merrill methodology, Citigroup could pay as much as \$500 million, say sources close to the negotiations, because it's so huge and because telecom analyst Jack Grubman

was the cheerleader for so many companies that went bankrupt. His positive ratings on telecoms helped Salomon Smith Barney earn about \$2.9 billion in fees in the sector between 1997 and 2001, Thomson Financial says. At the other end of the scale, Banc of America Securities and U.S. Bancorp Piper Jaffray might pay \$75 million or less, the sources say.

Spitzer and the SEC are eager to wrap up a settlement by yearend. But not all their fellow enforcers are happy about that. Their complaint: Some states started investigations only this summer, so there's a risk some banks could get off lightly because their cases aren't nailed down. Spitzer had 10 months to make his case against Merrill, says Andre Pineda, deputy commissioner for California's Corporations Dept., who is investigating Deutsche Bank. "He had all the facts, and he pushed for a number that would send as strong a message as possible to the public," he says. Pineda and others believe that with time to investigate thoroughly, the states would find solid evidence of misdeeds that merit big fines. But without the evidence, banks are making convincing cases for lower fines, he says.

The harsh reality is that the fines, even at the high end, are gnat bites for the banks. For Citigroup, even \$500 million is equivalent to a loss of just \$1,600 for an investor with a \$640,000 portfolio, notes Pineda. Investors who followed Grubman's advice should have been so lucky.

Clearly, setting arbitrary fines doesn't serve justice. And imposing an arbitrary time limit on the investigations into the banks makes matters worse.

By Heather Timmons in New York, with Mike McNamee in Washington

CITI: WAS IT WORTH IT?

Most investors lost money in telecom. Could Citigroup, whose Salomon Smith Barney unit grossed about \$2.9 billion in fees from telecom deals from 1997 through 2002, end up out of pocket, too?

Based on back-of-the-envelope calculations, Citi may indeed be lucky to break even. The bank declined to comment.

Subtract star analyst Jack Grubman's salary, for starters. Over the course of the boom, he made an estimated \$100 million. That includes a \$15 million loan Citi forgave this year. Earlier, it paid out \$5 million to the NASD in fines related to Grubman.

Then Citi may pay up to \$500 million to settle ongoing investigations into analysts' conflicts of interest. It also faces more than 60 class actions alleging bad analyst advice. Historically, a third of securities class actions are dismissed; the rest settle for an average of \$40 million each, so let's say \$1.6 billion for Citi.

Finally, Citi has taken write-downs and raised reserves for its own telecom investments. Using clues in its earnings reports, analysts figure that it has lost at least \$800 million so far.

Grand total: A tad more than \$3 billion. Seems that Citi's top-notch telecom business wasn't worth a candle.

By Heather Timmons

VANISHING TELECOM PROFITS

Citigroup earned huge fees from telecom share and debt issues during the boom. But but most will go up in smoke.

fees (1997-2002)	\$2.9 billion
Costs	\$3.0 billion
Grubman's Salary:	\$100 million
Fines:	505* million
Debt Writedowns:	800* million
Lawsuits:	1,600* million

*Estimates
Data: Thomson Financial, company reports, BusinessWeek



COMPANIES AND COMMUNITIES WIN-WIN PARTNERS

Executives have always looked for smarter ways to stay competitive, lower overhead, and increase revenue. Today's weak economy and the demands of multiple stakeholders have increased the need for new business solutions. In this context, low-income communities, once viewed solely as beneficiaries of philanthropic resources, are now considered viable markets in which to invest core business resources. Management practices and investments that benefit both the business bottom line and the community are becoming win-win strategies.

Win-win strategies take on many forms: companies seeking to develop cost-efficient suppliers, manage physical and financial assets, recruit and retain a qualified and diverse workforce, build brand image, and identify untapped markets are finding competitive advantage in low-income communities. But they don't always find it alone. The savviest companies form strategic alliances with powerful intermediaries — community economic developers, community development financial institutions, economic development corporations, employer organizations, trade organizations, and community colleges. These are the local partners that facilitate a company's expansion into new markets. They serve as cost-effective, value-added resources that conduct research and broker relationships as well as resources, and provide market intelligence, strategic consultation, and training solutions.

The Ford Foundation launched its Corporate Involvement Initiative in 1996 to encourage new management practices in human resources, marketing, product development, and investments that benefit both business and communities. This is distinctive from corporate philanthropy. The potential impact of targeting more business resources to low-income communities can be seen in the magnitude of the numbers: In 2001, corporate philanthropy in the United States accounted for \$10 billion while minority purchasing accounted for \$50 billion. Clearly, companies have enormous power to benefit low-income communities through their everyday operating decisions. And low-income communities have equally enormous power to advance corporate success.

Win-win strategies transcend all industries — among the leaders, TJX, Fleet-Boston Financial, State Farm, Pfizer, and many others (for more details see www.winwinpartner.com). Even more timely, they transcend the ups and downs of the business cycle. A recent report by the Initiative for a Competitive Inner City found that inner-city markets offer two-to-six times greater buying power per square mile as surrounding metro areas. The National Association of Manufacturers *Skills Gap 2001* tells us that despite the slowing economy, eighty percent of manufacturers continue to experience a moderate to serious shortage of qualified job candidates.

It's time for companies of all sizes to engage in these win-win business strategies.

— Michele Kahane, Ford Foundation

INNOVATIVE PARTNERSHIP SOLUTIONS

Faced with an increasing shortage of skilled workers, Manpower, the staffing and employment services giant, partners with community groups and nonprofit organizations to train residents of low-income communities and neighborhoods. Manpower and its corporate clients meet their employment needs — and, importantly, underprivileged individuals gain marketable skills. It's a real win-win.

Resource Consulting Group, a Manpower subsidiary, is working with Focus Hope, a Detroit-based nonprofit that provides technical training for former welfare recipients and other low-income individuals. Many graduates become certified machinists and those who qualify can enter a four-year college engineering program. Focus Hope pays for the tuition and provides students with a stipend.

In the past two years, some 2,000 graduates have been hired by Resource Consulting Group to work for Michigan-based employer, Visteon, a large automotive systems supplier. The partnership between Resource Consulting Group, Focus Hope, and Visteon is providing solutions to staffing challenges and new opportunities to low-income individuals.

Partnerships of this sort have inspired Manpower's workforce development initiative, TechReach, which prepares low-income individuals for well-paying career opportunities in technology-related fields. Implemented with businesses and community-based partnerships in 40 different programs throughout the country, these programs provide participants with lifelong marketable skills. Graduates have gone on to work for such major corporations as IBM, SunTrust Bank, Abbott Labs, and Unisys.

Winwinpartner.com is a resource for businesses interested in strategies that benefit the bottom line and build prosperous communities. See www.winwinpartner.com or contact Laufer Green Isaac at (310) 575-9200.

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Developments to Watch

EDITED BY OTIS PORT

SILICON GETS A REPRIEVE—BY WAY LESS THAN A HAIR

ONCE AGAIN, SILICON EXPERTS have prolonged the usefulness of the world's premier semiconductor material. The business of engraving ever-finer circuits in silicon was supposed to hit a wall around 2015, forcing the chip industry to switch to some exotic new concept, such as quantum physics—and chuck a half-century of accumulated know-how. That deadline has now been postponed, perhaps indefinitely, judging from several research papers at this year's International Electron Devices Meeting, which ended in San Francisco on Dec. 11.

The IEDM is a showcase for semiconductor breakthroughs with long-term implications, and two papers were especially upbeat. One dealt with the challenges of insulation. Engineers have long assumed that when circuit lines shrink to less than 10 nanometers wide, or 100,000 times thinner than a human hair, existing methods of insulating wires and transistors would prove too flimsy, leading to catastrophic short circuits. But researchers at Agere Systems (the former chipmaking arm of Lucent Technologies) recently discovered that the properties of the silicon-dioxide insulation used today actually change for the better as dimensions shrink into the nanoscale realm. So, no matter how fine these lines become, effective insulation could be available.

As if to prove the point, IBM scientists reported that they have made a working transistor only 6-nm wide. That's one-third smaller than the size projected to enter production in 2016. The company also found that ultrathin insulation seems feasible. Get ready for chips crammed with a billion transistors or more. ■



BETTER WARNINGS FOR DOROTHY

WHEN A TORNADO SWOOPS DOWN ON A COMMUNITY, residents have precious little time to get out of harm's way—generally no more than 11 minutes. To double that warning time and help save lives in the Midwest's tornado alley, a consortium led by the U.S. Navy and the National Weather Service is devising a tornado-detection system using fancy radar from Lockheed Martin.

Current systems rely on Doppler radar with a dish antenna that rotates to scan the surrounding terrain. Only when it is pointing in the right direction can the antenna spot an approaching funnel or the atmospheric changes that often precede a storm. But Lockheed's phased-array radar, developed for Navy ships, has an antenna that can be electronically steered to look instantly in any direction—and lock onto ominous signs to speed computer analysis. "It can scan a whole area much faster," says Scott A. Sandgathe, a meteorologist at the University of Washington in Seattle. Tests are slated for April at a \$25 million facility being built in Norman, Okla., funded mainly by the Office of Naval Research.

Catherine Arnst

TEACHING THOSE MOLECULES TO TAKE ORDERS

NANOTECHNOLOGISTS BELIEVE that proteins and other complex molecules might make excellent micromachines more versatile than anything an engineer could build from scratch. But how do you customize the specific molecule or tell it what to do?

Scientists at Massachusetts Institute of Technology are tackling these issues by fitting molecules with tiny antennae, then sending simple instructions via radio. As described at a recent Materials Research Society meeting in Boston, MIT Associate Professor Joseph Jacobson and his team attach gold nanoparticles to DNA molecules in a solution inside a plastic tube. When exposed to an oscillating magnetic field, the gold-tagged DNA unwound, then wound back up when the power was shut off. Ultimately, this technique could let doctors switch off harmful genes in a cell or activate good ones. And even size machines could be created by radioing instructions to enzymes, directing them to cut and paste pieces of proteins.

Neil Gro

INNOVATIONS

■ Boston researchers have discovered that zebrafish can regenerate damaged heart muscle—a finding that could pave the way for regeneration of injured heart tissue in people. In the Dec. 13 issue of *Science*, a team led by Dr. Mark T. Keating of the Howard Hughes Medical Institute at Children's Hospital reports that it surgically removed 20% of the muscle from the lower ventricle of zebrafish and then returned them to water. Within a week, the fish were swimming normally, and within two months their hearts had regained their original size

and shape. Recognizing that the zebrafish genome shares many characteristics with that of humans, the scientists will now investigate which genes are responsible for the felicitous regrowth.

■ Europe is thinking big about a new telescope—really big. Its mirror would be 100 meters (330 feet) in diameter, dwarfing the current champs, the twin 10-meter telescopes at the W.M. Keck Observatory on the summit of Hawaii's Mauna Kea volcano. With a mirror as big as a football field,

astronomers might see earth-size planets circling nearby stars instead of just inferring their presence on the basis of gravitational distortions. Scientists working on the monster telescope have asked the European Union for funding.



HAWAII 'SCOPES: Biggest so far

ANKING HE WELCOME MAT

uddenly, foreign MBA students face big obstacles in the U.S.

Alberto Fumo is the type of student business schools crave. His high marks and international experience led the budding financier admission officers at Yale University's School of Management and Cornell University's Johnson School. But the Italian native chose McDonough Business School rather than face a trifecta of trouble with a U.S. visa: an imminent drop in work visas, a hiring slowdown for MBAs, and less school financial aid.

After a decade-long buildup of overseas applicants seeking the prestige—and salary—of a U.S. business degree, B-schools are concerned about a growing wariness of students like Fumo. In the 1990s, international students became the fastest-growing pool of prospective MBA applicants, helping push total applications to record highs in 2001. Now, in that order, the weak economy, coupled with a looming drop in the availability of H-1B work visas, is taking its toll. International enrollment at *BusinessWeek's* Top 30 schools slipped from 32% in 2000 to 30% in 2002 and is estimated to go down yet in 2004. The ultimate concern for U.S. B-schools is the new unwelcome mat driving away the world's best candidates. "What is that going to do 10 years from now to the talent pool?" wonders Vijay Govindarajan, strategy professor at Dartmouth's Amos Tuck school. The pipeline may get a lot thinner. In October, 2003, a law increasing the number of H-1B visas is set to expire, leaving available H-1Bs from 195,000 to 65,000. The business lobby is expected to fight to maintain the number, but with the economy soft, it's likely to be an uphill battle. While MBAs would make up a small portion of the applicant pool, if all visas are issued before students get to commencement, jobless foreign grads will have no choice but to go home.

What's if they get here in the first place. Admissions officers urge foreigners to apply early to cope with delays in

State Dept. background checks. "There are some places in the world where we have special concerns," says a State Dept. spokesman. Europeans have reported little trouble; applicants from the Middle East and China can expect tie-ups.

Massive debt, which can exceed \$100,000 at top private schools, is also a prob-

lem. Repayment is a high hurdle if you hail from a country where \$5,000 is a good yearly wage. They're not supposed to say so when they apply for the student F-1 visa, but many foreign students—especially those from developing nations—plan to stay in the U.S. after graduation to help pay down their debt. But suddenly, staying stateside is far from guaranteed. Companies with tight budgets and hiring slowdowns are beginning to cut down on hiring non-U.S. candidates. It can cost upwards of \$10,000 in administrative expenses and legal fees to sponsor one foreign applicant through the visa process. And since September 11, there's no guarantee the recruit will be approved by the Immigration & Naturalization Service.

Already, at the University of California at Los Angeles' Anderson School, only 15% of companies recruiting on campus say they'll consider a foreigner. Many consumer-products outfits—like Johnson & Johnson and Procter & Gamble Co.—that recruit generalists are sticking to U.S. hires. "Those types of positions would be very difficult to bring in" on a visa, says David Wittenberg, director of investment evaluation at Weyerhaeuser Co.

To make matters worse, B-schools have become less generous with loans. At the University of Virginia's Darden School, loans given without a co-signer will be capped at \$34,000 a year, covering only tuition. As its default rates rise, University of Pennsylvania's Wharton School, long considered among the most generous to foreign students, also capped loans and upped interest charges this fall.

The changed climate has made foreign students even more anxious in a tight job market. One student at Darden found that most consulting companies wouldn't consider him for positions in U.S. offices. He recently sent out about 25 résumés for summer internship positions and is still hopeful he'll get one. "I wouldn't be able to pay off my debt if I had to go back to [my home country]," he laments.

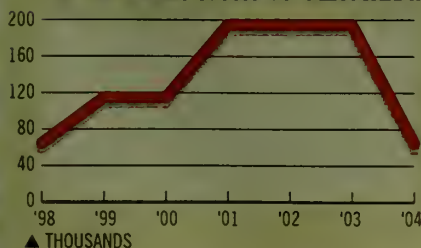
B-school deans across the country are crossing their fingers for an economic turnaround. Otherwise, they'll watch a decade's worth of work recruiting foreign students evaporate. "If this happens, we are the losers," says Govindarajan. It would be a setback felt around the world.

By Brian Hinde in New York

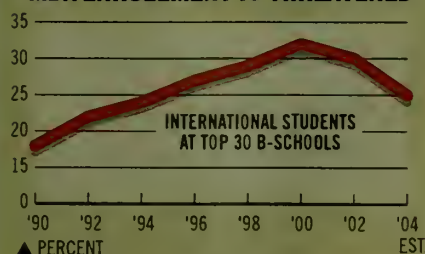


LOSING GROUND

AS THE NUMBER OF ALLOTTED H-1B WORK VISAS IS SLASHED...



...GROWTH IN FOREIGN-STUDENT MBA ENROLLMENT IS THREATENED



Data: *BusinessWeek*, INS



x7



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Investor

MAKING LIFE RICHER

Cool Kids' Gear

Great Computer Desks
And Gadgets

Page 98



Moon Desk & Chair
by Dynacraft

THE FINE PRINT 94 Watch
The Inventories

WINE 99 French vs.
California Bubbies

BARKER 100 Tax Loss
Strategies



**One woman changed the face of American surgery.
Surely all of us working together can keep healthcare affordable.**

Helen Octavia Dickens, M.D. first black woman to become a Fellow of the American College of Surgeons

Insurers. Drug companies. Hospitals. Physicians. Lawmakers. Employers. Consumers. We all need to work together to keep healthcare affordable. And the people of the BlueCross BlueShield system are leading the way.

New research we've commissioned shows that hospital spending is now the leading driver of healthcare costs. Two reasons why are the potential overuse of expensive, "me-too" medical technologies and a surge in hospital consolidations.

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After all, the Blues collectively insure one in three Americans. We know the size of the challenge. And we know that working together, all of us can keep healthcare affordable.

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EDITED BY
TODDI GUTNER

THE STAT

32

PERCENT of undergrads at four-year colleges have credit-card debt. Of these, 31% owe more than \$2,000. The data is based on 1,139 students at 13 campuses in 20 states.

Data: Students in Free Enterprise

2 DAYS OF GIFTS



If you'd like to give seven gifts—a swimmer to your true love, order them rather than online—your delivery costs will kill you. This applies to 9 of the 12 items in PNC Advisors' annual Christmas Price Index, based on 12 items in the holiday season. In all, the 12 gifts cost \$558 when bought locally and \$24,595 over the Internet.

LOCAL INTERNET

Stridge in Pear Tree	\$102	\$201
Ele Doves	58	100
Each Hens	15	173
ing Birds	316	330
l Rings	383	173
se-a-Laying	150	375
ns-a-ming	2,100	4,620
Is-a-Milking	41	296
es Dancing	4,107	6,450
ds-a-Leaping	3,921	9,641
ers Piping	1,614	1,550
mmers mming	1,749	688

PNC Advisors



THE MARKETS

Burn Rate

IT'S HARD WORK TO BURN MONEY—at least if you do it the old-fashioned way. Just ask Ralph Wanger, portfolio manager of \$5 billion **Liberty Acorn Fund**. In the fund's most recent quarterly report, Wanger calculated how long it would take his 20 analysts to burn \$956 million, the amount of money the fund lost during the first nine months of 2002. "If one person diligently burned [a] \$100 bill at the rate of one bill every 10 seconds and worked seven hours a day, five days a week, 50 weeks a year, that one person could burn up \$63 million in a year," he writes.

Working together, though, all 20 analysts could burn the money in the same amount of time as it took them to lose the money in the stock market. "Obviously our people did not stoke fires for nine months," notes Wanger. "They worked hard and showed enough skill to lose less money than the market averages. Still, the assets did disappear, and we didn't even have the fun of the weenie roast." Imagine the size of the bonfire if every mutual fund manager followed suit.

Lewis Braham

TOYS

RECALL SITE

What do Brio's pull-along snail and Rose Art Industries' Soap Making Kit have in common? Both toys had a manufacturer or **U.S. Consumer Product Safety Commission recall**. For a list of the 350 major recalled toys mostly since April, 2001, click on the Consumer Federation of America's new Web site, www.safechild.net/toyrecalldatabase.



TIME OFF

BLANKET BEAUTY

A startling array of **quilts** that look like Abstract Expressionist paintings are on view at the **Whitney Museum of American Art** in New York through Mar. 2. They are the work of the women of **Gee's Bend**, 50 miles south of Selma, Ala. Because the town is surrounded on three sides by the Alabama River, the quilters were isolated and not swayed by outside influences. As a result, their quilts have unorthodox designs.



How Efficient Is that Company?

You'll know by ferreting out how often it turns over its inventory and receivables. **BY SUSAN SCHERREIK**

IN TODAY'S TOUGH business climate, many companies succeed by running financially efficient operations. That means they keep costs down—and reduce the need to borrow—by trimming their inventories and speeding up collections of what's owed them. "At the end of the day, all businesses need to sell stuff as quickly as possible and then turn those sales into cash," says Charles Carlson, contributing editor of *Dow Theory Forecasts*, an investment newsletter.

In this installment of The Fine Print, an ongoing series on analyzing financial statements, we'll help you figure out what numbers you need to pull from corporate documents to make your own assessment of how well a company is managing its inventory and receivables. Analyses of these critical assets can help identify investment opportunities as well as uncover positive and negative trends before they show up in the earnings statements (table, page 96).

You can obtain the necessary documents, the 10-Qs and 10-Ks, at the Securities & Exchange Commission's Web site, www.sec.gov. Remember to also check company Internet sites. Often,

companies issue quarterly financial data on their sites weeks before they file that information with the SEC.

INVENTORIES

Begin by looking at inventory levels at Dell Computer. Long known for its efficient operations, the computer powerhouse builds to order, which allows it to keep inventories at a bare minimum. The nation's leading PC seller turns over, or depletes, its inventory every 3.8 days vs. 4.8 days a year ago. That key number is not usually spelled out, so you have to extract it from the data.

To get this figure, go to the income statement and start with the cost of goods sold. You'll find that below the sales or revenue line. Dell's cost of revenue—the company uses that term instead of "cost of goods sold"—was \$14.4 billion in the past two quarters and further research would show \$27.7 billion for the four quarters.

Then flip to the balance sheet, and under assets, look for the inventory figure. Take the inventory for the most recent quarter, \$307 million, and for the same quarter the year before, \$269 million, and average the two. Then divide that average, \$288 million, into the cost of goods sold, \$27.7 billion, and you get

96.2, which is the annual turnover ratio. Now, divide the number of days in a year, 365, by that ratio, 96.2, and you get 3.8. Roughly speaking, that means it takes Dell less than four days to turn over its entire inventory. (Using the latest quarterly financial data from Dell's Web site, the company reports four days of inventory on hand. But this figure is calculated on a quarterly rather than annualized basis.)

Still, that's only a snapshot. What counts is whether the days-to-sell inventory figure is improving or deteriorating. So you need to repeat the calculation going back another four quarters and then another four quarters after that. That way, you'll have three years of data for comparison.





sell inventory? You have to question why. Higher inventories are normal, say, if a company is planning to introduce a product. But if there's no such rollout in the cards, the increase could just indicate that unwanted goods are building up in the warehouses. That could presage price slashing or write-downs.

RECEIVABLES

A company may make its revenues and inventories look good by clearing the shelves. So you have to ask if the seller is getting paid in cash right away, which is good. Waiting for the money isn't as good since some of what's owed may never be paid. The key: Determine how many days, on average, it's taking to collect its accounts receivable, or what customers owe.

The process is similar to figuring out the number of days it takes to sell inventory. From the income statement, you'll need annual revenues; from the balance sheet, accounts receivable. As you did with inventories, take the latest quarter's receivables and the year-before quarter's receivables and average the two. With Dell, that's \$33.73 billion in revenues divided by \$2.482 billion in receivables to yield a turnover ratio of 13.59. This shows how many times the company turned over its receivables during the past 12 months. Divide the days in the year, 365, by 13.59, and you get

27 days. So as of the latest reporting period, customers took an average of 27 days to pay for merchandise, down from 32 days the year before.

The sooner a company gets its customers to pay up, the sooner it has the cash to pay salaries, supplies, and lenders. If a company's collection period is lengthening, it could signal trouble. It may mean the company is extending credit to boost sales, and that could be problematic if the buyers are strapped.

STACKING UP

It's not enough to simply examine how well a company controls inventory or collects receivables. Step back and look at how it stacks up to its rivals.

Ideally, you want to see that a company is shortening both the days

GETTING THE RIGHT NUMBERS:

To determine a company's efficiency, you'll need to pull revenue figures from the income statement, and accounts receivable and inventories from the asset side of the balance sheet.

	November 1, 2002	August 2, 2002
Net revenue		
Cost of revenue	\$9,144 7,482	\$8,459 6,944
Gross margin	1,662	1,515
Selling, general and administrative	787	727
Research, development and engineering	117	111
Total operating expenses	904	838
Operating income	758	677
Investment and other income, net	44	49
Income before income taxes		
Income tax provision		

Assets:

	November 1, 2002	August 2, 2002	November 2, (b) 2001
Current assets:			
Cash and cash equivalents	\$4,034 270	\$3,725 319	\$3,442 309
Short term investments			2,303
Accounts receivable, net	2,661 307	2,590 291	269
Inventories, net	1,483	1,358	1,377
Other	8,755	8,283	7,700
Total current assets			806
Property, plant and equipment, net	882	872	4,267
Investments	4,755 320	4,589 318	514
Other non-current assets			\$13,287
Total assets	\$14,712	\$14,062	

ext, you need to do a reality check, if you've uncovered a favorable trend in inventories. Maybe prices are flying off the shelves because the company is slashing prices. Is Dell's strategy? Go to the income statement again to find the profit margin, which is revenue minus cost of revenue. The key here is to check the trend in gross margins as a percentage of revenue. You want to see steady or climbing profit margins. Shrinking margins may signal that a company is slashing prices to move sales. That's not the case here. Dell's gross margins have edged up to 18.2% as a percentage of sales in the quarter ended November 1, from 17.6% the previous year. But if there's an increase in days to

IMPROVING EFFICIENCY

Companies that are reducing their inventories and speeding up payments can be good investments. Some examples:

COMPANY /SYMBOL	DAYS OF INVENTORY		DAYS OF RECEIVABLES		COMPANY /SYMBOL	DAYS OF INVENTORY		DAYS OF RECEIVABLES	
	RECENT QUARTER	YEAR AGO QUARTER	RECENT QUARTER	YEAR AGO QUARTER		RECENT QUARTER	YEAR AGO QUARTER	RECENT QUARTER	YEAR AGO QUARTER
AFFILIATED COMP. SVCS. A ACS	1	2	76	84	NVIDIA NVDA	44	58	25	37
CONOCOPHILLIPS COP	37	40	25	28	OMNICOM GROUP OMC	28	29	184	197
DIEBOLD DBD	73	80	86	93	RENAL CARE GROUP RCI	9	10	57	61
GILLETTE G	155	175	65	84	SHERWIN-WILLIAMS SHW	80	86	46	51
H & R BLOCK HRB	20	39	132	265	SNAP-ON SNA	141	150	104	105
LEGGETT & PLATT LEG	69	73	59	62	SOUTHERN CO. SO	48	49	51	95
LIZ CLAIBORNE LIZ	91	94	60	64	ST. JUDE MEDICAL STJ	200	237	85	90
MILLIPORE MIL	129	157	80	104	STERIS STE	63	76	72	85
MYLAN LABORATORIES MYL	141	154	61	70	STRYKER SYK	161	183	45	49
NOBLE NE	2	7	65	66	SUPERIOR INDUSTRIES INTL SUP	37	44	62	64
NORTHROP GRUMMAN NOC	31	38	51	59	YUM BRANDS YUM	4	7	9	16

Data: Dow Theory Forecasts, BusinessWeek

of inventory it keeps on hand and its collection period. You may find that a company has been backsliding in these areas, or simply holding steady. For instance, roughly half of the companies in the Russell 3000 stock index saw a lengthening in days of inventory on hand and collection periods during the past year, notes Carlson of *Dow Theory*

Forecasts. These are not necessarily worrisome if a company's rivals are in a similar or worse situation. By the same measure, a company showing improvement may not get much traction if its competitors are making greater strides.

Keep in mind that these efficiency measures apply largely to companies that make or sell goods. Service compa-

nies don't hold inventory, but you use the accounts receivables formula to examine how efficiently they collect what's owed.

Sure, it takes work to ferret out inventory and receivables ratios from financial reports. But getting a read on these figures may tell you things that revenue and profit reports won't.

HEALTH

Hot Seat: A Chair That Knows Where it Hurts

The Japanese swear by the curative powers of shiatsu, a massage technique involving the kneading, tapping, and pushing of 350 pressure points all over the body that are said to regulate the flow of life energy, or *ki*.

Now, you can get a shiatsu massage at home with the INADA chair.

Available in the U.S. for \$3,000 to \$3,500

INADA'S SHIATSU CHAIR: Sensors detect which muscles are stiff before getting to work



(www.inada-chair.com), the recliner's infrared sensors detect stiff muscles and pressure points across the neck, back, torso, hips, and legs, then direct pins and rollers to work. **Set programs provide a full-body massage or home in on specific sore spots.**

I tested the chair on a Tokyo shopping excursion. I don't know if a steady diet of shiatsu can ward off disease, but the contracting and expanding air bags pumped energy into my weary legs. And the neck massage felt heavenly.

Brian Brem

The Smoothest SUV Yet?

Toyota's new 4Runner is sweet but pricey.

DAVID WELCH



SPORT EDITION: Enhanced suspension and stability

CLIMBING INTO the well-appointed cockpit of the new Toyota 4Runner, I was reminded of the overall allure of the Japanese carmaker's vehicles: Everything fits together just

perfectly. Even though Toyota uses plastic trim—not real brushed chrome—on the dashboard, it doesn't feel like the stuff you get in, say, a General Motors car. Toyota Motor's craftsmanship is rivaled by few auto makers. When I fired up the new 4.7-liter V-8 engine—a first for the historically V-6-powered 4Runner—and I could barely get it started. At 235 horsepower and 24 miles per gallon in the city, it's not as powerful or fuel-efficient as the motor in midsize sport-utility vehicles, the Chevrolet TrailBlazer and GMC Envoy.

IN YOUR LANE

For an SUV, the 4Runner drives like a dream. The acceleration is just adequate, but the transmission is smooth, and the vehicle handles better than any other sport-ute I've driven. My test vehicle was the Sport Edition, which is fitted with a great new suspension and some stability controls. If you make a too-tight turn, the suspen-

sion keeps the truck balanced, letting you stay in your lane. I hit the accelerator on packed snow, and the traction-control system kicked in, slowing some wheels and accelerating others to keep me headed straight. The Sport Edition also slows to four miles per hour automatically when going down a steep hill, though that feature is unlikely to kick in unless you're driving off-road.

The downside to this gadget-packed carriage is price. The 4Runner Sport Edition ranges from \$29,800 with two-wheel drive to a \$36,135 fully-loaded four-wheel-drive model. Even at that lofty price, you don't get some of the nicer features that a Ford Explorer or Chevy TrailBlazer offers for about a thousand less. Examples: Only cloth seats are available in this price range, and they are controlled with an unwieldy pairing of knob and lever. To recline the seat, I had to wedge my hand between the door and seat cushion and crank a plastic lever. To get goodies such as automatic leather seats, you have to buy the 4Runner Limited Edition, which can cost more than \$40,000.

Toyota's newest SUV drives so nicely that it may be worth the money. But you'll pay a fat price for real comfort. ■



MEOW! PAMPER THAT PET

Come on. You buy gifts for friends and even mere acquaintances, and they're not nearly as loving or loyal. Your pet would be thrilled to get one of these.

1 Kitty-Warmer ▲

Cozy \$60 faux lambskin bed from Plow & Hearth warms up to 102 degrees when cats curl up in it (800 494-7544, plowhearth.com).

2 Parkas For Pooches

Fleece and spandex Apache River Dog Coat for staying warm and toasty on those chilly winter walks.

Sizes from 6- to 34-inch (neck to tail), \$36 to \$70 (800 348-5673, horse-blankets.com).



3 Cat's Meow

Felt mice, yarn mice, fur mice, jingle-bell mice: 13 mice and a couple of glitter balls in all, in a holiday stocking for \$10 from Drs. Foster & Smith (800 826-7206, drsfostersmith.com).

4 Buon Appetito

More than 300 all-natural liver biscotti in an 8-ounce bag (\$6.50), or hypoallergenic doggie treats for a dollar more (888 500-3647, liverbiscotti.com).

Larry Armstrong



Look, Ma, No Neck Pain

How to set up an ergonomically correct workstation for your kids.

BY ANNE FIELD



EVERYONE KNOWS that a poorly configured computer workstation is bad for your health. But did you ever think about how it can affect your children? Ergonomists and pediatricians are becoming increasingly alarmed about the potential for computer setups to cause in children the same physical ailments plaguing many adult users: a range of musculoskeletal problems, from neck pain to carpal tunnel syndrome. With kids as young as 2 starting to use computers and some middle school students sitting at the PC for up to four hours a day, experts figure it's only a matter of time before repetitive stress injuries become a serious problem. "These children could become the next generation of walking wounded," says Karen Jacobs, a professor in Boston University's occupational therapy program.

In the meantime, you can do a lot to set up a home workstation that's not a health hazard. You can buy some of the many child-size computer accessories and furniture available on the market or put together your own homegrown solution. In either case, the underlying approach is the same. "What works for a 3-year-old might not work for an 11-year-old," says Anne Kramer, CFO of the International Child-

JUST RIGHT:

Wild Zoo's computer desk for 6- to 10-year-olds has the keyboard at the correct height

dren's Ergonomic Foundation (925 947207) and CEO of ErgoWorks, a Belmont (Calif.) computer accessories maker.

your best bet is to try to build a measure of adaptability into all your components.

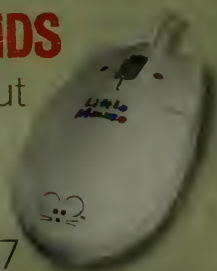
CHAIR AND DESK

The rule of thumb is that your child's legs should be at right angles to the floor, with knees slightly below the hips and firmly on the floor or a footrest. The reason: If the seat is high, there will be too much pressure on the thighs; if it's low, it stresses the lower back. Dangling feet can cut off circulation to the back of the knees and impinge on the nerves. The back of the chair should also support the contours of the lower back so your child doesn't suffer a sore back and no-

The typical office chair isn't designed for users under 5 tall. The ideal solution is an adjustable child's chair like from ErgoWorks (askergoworks.com), which is introducing two models costing about \$350 that let you change the height

FOR SMALL HANDS

1 LittleMouse About three-quarters the size of a grown-up model, it costs \$24.95 from Secret7



2 KidzMouse This half-size mouse, which comes in fanciful designs, helps prevent tendinitis



SMART SHOPPING

Bubbly: Is Champagne Worth the Extra Cash?

In this age of thrifty consumerism, can you serve California sparkling wine instead of Champagne?

Editors at *BusinessWeek* compared nonvintage bruts of three French vineyards with their California cousins.



■ Moët & Chandon Brut Imperial

(\$33.25) **vs. Chandon Brut Napa**

(\$14.95): One taster said the California Napa "had more taste [and] was richer," while another noted the Moët was "very clean-tasting, yet full-bodied." Since most thought both brands were very good, only 20% of our tipplers said they would be willing to pay the \$18 or so per-bottle premium for the Moët.

■ Veuve Clicquot (\$33.95) **vs. Pacific**

Echo (\$16.50): The Veuve Clicquot Yellow Label was the hands-down favorite of all six tasted. The Veuve had "a more complex taste," with richer color and better bubbles. Still, just 25% were willing to pay the 106% markup over Echo. As one taster said: "The Pacific Echo is nice enough on its own to justify not paying the extra expense."

■ Mumm Cordon Rouge (\$27.95) **vs.**

Mumm Cuvee Napa (\$16.95): The Rouge beat the Napa 5 to 1. Almost half the tasters were even willing to pay the premium.

pan, and lumbar support. Or, for \$50, there's a chair from Dynacraft/Oakcraft (dynakidz.com), aimed at ages 2 to 10, with four adjustments. You can also buy an adjustable desk that can be raised to five different heights, for a total of \$100. An easier solution is to have your child sit on some cushioned plop phone books on the floor for a footrest.

BOARD AND MOUSE

If you want your kids to use the keyboard and mouse without having to lift their shoulders or arms (meaning the components are too high) or bend their wrists (too low). Buy an adjustable keyboard tray (\$150-\$200), which can be fastened to the bottom of your work surface.

Or you can purchase a kid-size computer desk like one from Wild Zoo (wildzoo.com). The \$169 preschool model comes with a chair low enough for a 2-year-old. For \$29 more, you can buy a kit with fasteners that attach to the furniture and raise it a total of four inches. There's also a bigger \$189 elementary school model for 6- to 10-year-olds. At the least, "having your child hold the keyboard on his lap is better than letting him hunch up over a high surface," says Cheryl Bennett, an ergonomist at Lawrence Livermore National Laboratory in Livermore, Calif.

Standard keyboards and mice aren't made to fit kids' hands, either. Their fingers have to stretch a lot, causing such problems as tendinitis. In both cases, there are smaller products on the market, such as LittleFingers from Datadesk Technologies (datadesktech.com), a keyboard that costs \$69.95 with a built-in trackball and \$49.95 without it. KidzMouse, for \$24.95, is about half the size of a regular model and comes in such designs as a dinosaur and bumblebee (kidzmouse.com).

MONITOR

Placement is critical. To avoid neck strain, the monitor should be directly in front of your child, about an arm's length away, with the top of the screen at eye level. You can get a monitor that can be moved up or down, or get a desk like Dynacraft's kids' desk, which has an adjustable monitor shelf. Of course, if the monitor is too low, you can place it on some phone books; too high, raise the chair. Install your workstation in the kitchen or den so you can observe your kids' posture and monitor how long they've been sitting there. Enforcing two-minute breaks every 20 to 30 minutes is crucial. No matter how perfectly positioned the computer is, kids can run into trouble if they don't get up and stretch regularly. ■

LittleFingers

can buy a pint-size keyboard with a built-in trackball





THE BEST WAYS TO RING UP TAX LOSSES

BY ROBERT BARKER rb@businessweek.com

AS THE DAYS AND LONG NIGHTS of 2002 dwindle to a precious few, individual investors' thoughts turn to, yes, taxes. Specifically, to next April's tax bills and how they might be cut by recognizing investment losses before yearend. Yet whenever my own thoughts turn this way, they swiftly skid off toward Jimi Hendrix, as the variety of so-called "tax-loss harvesting" strategies inevitably leaves me in a purple haze of confusion.

If capital gains, losses, and the tax code zone you out, too, then you know why I was quick to check out some fresh academic research into investment taxes. Twenty years have passed since economists first looked closely at juggling a portfolio's gains and losses to yield the highest ultimate after-tax return. Yet some of the conclusions are contradictory, and most flow from the kind of otherworldly models that are so pleasing to academics—and unhelpful to everyday investors. So a trio of finance professors at Indiana's Ball State University went looking for practical answers, which they presented in November's *Journal of Financial Planning*.

The pros—Terry Zivney, James Hoban Jr., and John Ledbetter—wanted to know which of two tax-loss harvesting strategies would leave them richer: the traditional approach of selling losers, deducting the capital losses from taxable income, and reinvesting the proceeds; or a more aggressive strategy that, besides selling losers, calls for selling stocks

with long-term gains and reinvesting in the same stocks? The second scheme, while it means a capital-gains tax on the winners, resets their tax basis at a higher level, lessening the future tax bite. The researchers also looked at how a simple buy-and-hold strategy, with no losses taken or taxes paid until the portfolio was liquidated, would pan out. They tested the data by simulating market conditions that resemble the long-term behavior of stocks (table).

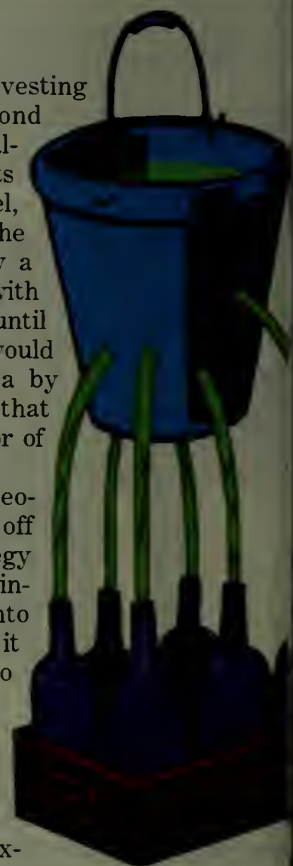
What did they learn? Most people most of the time are better off using the loss-harvesting strategy of selling losers and letting winners ride. Much math went into that simple statement, and from it I have settled on answers to three questions that keep bugging me:

■ **Should I sell all of my losers or just enough for \$3,000 in losses?** The most in net capital losses that Uncle Sam lets taxpayers deduct against other income is \$3,000 a year. But it makes perfect sense to recognize all losses each year and carry forward to future tax years anything above \$3,000. "People don't like to realize losses, but they have to get over it," says Vanguard Group tax specialist Dickson. "Losses are an asset—take advantage."

■ **Should I also sell some winners to reset their tax basis higher level?** No, at least not if my sole goal is a higher after-tax return on investment. If, instead, I have the additional goal of trying to better diversify my portfolio by selling winners and reinvesting in other stocks or funds, then yes. In that case, I might lower my portfolio's risk at little cost by offsetting realized gains with losses.

■ **Should I sell mutual-fund shares even if it means paying a redemption fee?** Probably yes. More and more mutual funds force investors to pay a toll when selling shares. In these times, as with brokerage commissions or any other transaction cost, here's the only question to ask: Is the cost of trading less than my tax savings? If so, then by all means make the trade.

Managing investments for a high total return is a lot easier, never mind the taxes. But the time to do both is right now.



TAX MANAGEMENT? YES, BUT HOW?

Researchers were curious to see which strategy delivered higher after-tax returns: traditional tax-loss harvesting, in which only investment losses are recognized each year, or the more aggressive approach of recognizing both losses and long-term gains, in order to raise the gainers' tax basis.

Strategy	PORTFOLIO VALUE AFTER VARIOUS PERIODS				
	1 Yr.	3 Yrs.	5 Yrs.	7 Yrs.	15 Yrs.
Buy and hold	\$11,689	\$15,070	\$14,222	\$22,428	\$63,860
Traditional harvesting	11,755	15,204	14,351	22,832	66,222
Aggressive harvesting	11,755	14,667	14,014	20,377	47,990

Hypothetical 10-stock portfolio starting with \$1,000 in each stock, each of which delivers 10% mean annual return, with average year-to-year volatility. Return also includes two percentage points from dividends. Ordinary income is taxed at 30%, long-term capital gains at 20%, and the portfolio is liquidated at the end of each period.

Data: Terry L. Zivney, James P. Hoban Jr., and John H. Ledbetter, Ball State University

BusinessWeek online

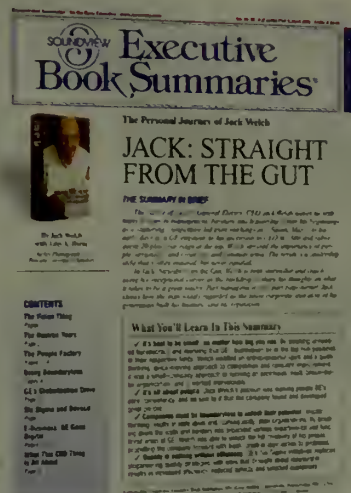
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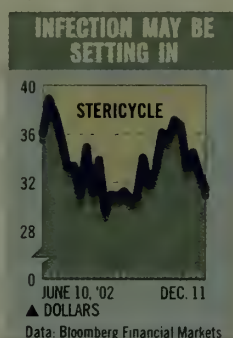
THE SHORTS SEE FURTHER ANTITRUST WOES FOR STERICYCLE. THE DEAL FOR HEINZ BRANDS MAY BOOST DEL MONTE EVENTUALLY SIGA SCIENTISTS ARE HELPING THE ARMY DEVELOP BIODEFENSES

BY GENE G. MARCIAL

Stericycle's Wounds

When Stericycle (SRCL) was featured in this column on May 27, the Street was high on the top U.S. provider of medical-waste disposal. The shares, trading at split-adjusted 36, rose to 40 by mid-June. Since then, however, they have sagged to 31, because of antitrust ills. Many analysts remain bullish—but not Evan Sturza of Sturza's Institutional Research, who thinks Stericycle is overvalued relative to its peers in waste management, and rates it a sell. He says the stock is worth 22. One hedge-fund manager shorting the stock sees Stericycle going even lower—to 16 in 12 months.

This pro's major concern is that Stericycle's settlement in August of an antitrust investigation in Arizona—and a similar one in Utah—"could open up a Pandora's box [in other states]." The probes were sparked by Stericycle's 1997 purchase of the Arizona medical-waste assets of Browning-Ferris Industries and its sale of Utah and Colorado properties to Browning. Stericycle agreed to pay Arizona \$320,000 in civil penalties to settle and hopes to do the same with Utah. Although CEO Mark Miller says he is unaware of any other antitrust inquiries, Sturza feels the settlement "highlights Stericycle's anticompetitive pricing practices." So he expects more trouble from other state attorneys general. The shorts are also alarmed by corporate insider selling at Stericycle. In November alone, insiders sold stock worth \$22 million. Among them: Chairman Jack Schuler and Miller, who sold at 34 to 36 for a total of \$8.8 million and \$4.5 million, respectively. Miller says that despite the selling, management still owns 18% of the stock. Street consensus earnings estimates for Stericycle: \$1.05 a share for 2002 and \$1.29 for 2003.



Del Monte Could Ripen Into a Real Peach

Shares of Del Monte Foods (DLM), now at 9, are apt to fall when the fruit-and-vegetable canner completes its purchase of H.J. Heinz' pet-food, private-label soup, baby-food, and Star-Kist tuna businesses. Del Monte will issue 160 million new shares to pay for them. Analysts have cooled on Del Monte, in anticipation of selling by Heinz shareholders who will get the

new shares. But that's what Scott Kuensell hopes will happen: "We've been buying, and we will buy more if the stock drops," says Kuensell, managing director at Brandywine Asset Management. Because the Heinz deal will transform Del Monte into a larger enterprise—with sales of \$3 billion, vs. its current \$1.2 billion—and boost its market cap from \$500 million to nearly \$2 billion, Del Monte could be a juicy target for other food companies, says Kuensell. Texas Pacific Group, which owns 46% of Del Monte, rejected a recent \$12-a-share offer. But the buyout outfit may craft a deal for more, says Kuensell, who sees the stock at 12 in two years. He predicts 2003 earnings of 90¢ a share down from 2002's estimated 94¢, because of the extra share



Siga Technologies Takes Aim at Smallpox

Tiny biotech Siga Technologies (SIGA) is not for the weak of heart. But it could become a key player in biowarfare defense. The stock's recent climb from 1 to 1.65 reflects the role of Siga, led by Chief Scientific Officer Dennis Hruby, in developing a smallpox antiviral drug. Until now, there has been no effective treatment for smallpox, and the vaccines available have serious side effects. Hruby heads a Siga-Oregon State University group working on a remedy. Its research has captured the interest of the U.S. military, which has granted \$1.6 million to Siga to develop a smallpox drug, say sources close to the situation. Hruby wouldn't comment on a military contract. But Siga's animal testing will begin early next year, and a drug could be approved in two years. The Army's aim is to develop compounds that will attack an enzyme that spreads smallpox. Peter Cardillo of Global Partners Securities, who rates the stock a "speculative buy," says Siga has identified two key smallpox proteins—and is designing inhibitors for an antiviral drug in pill form. Cardillo has a 12-month price target of 4 to



BusinessWeek online Read Gene Marcial's Inside Wall Street Online Tuesday afternoons at www.businessweek.com today.htm. And see him Fridays at 1:40 p.m. EST on CNN's *The Money Gang*.

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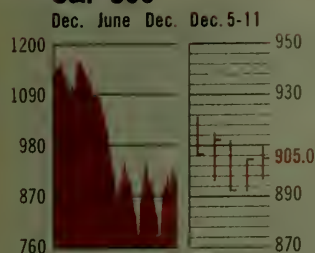
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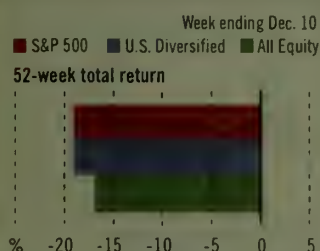
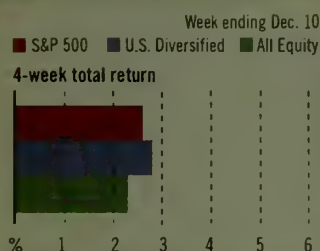


COMMENTARY

The equity markets are on track to end the year not with a bang, but a groan. Adding to investor gloom was a Dec. 6 report from the Labor Dept. that the unemployment rate rose to 6% in November as the economy shed another 40,000 jobs. For the week, the S&P 500, the Dow, and NASDAQ fell 1.4%, 1.7%, and 2.4%, respectively.

Data: Bloomberg Financial Markets (Reuters)

MUTUAL FUNDS



Data: Standard & Poor's

U.S. MARKETS

	DEC. 11	WEEK	% CHANGE YEAR TO DATE	LAST 12 MONTHS
S&P 500	905.0	-1.4	-21.2	-20.4
Dow Jones Industrials	8589.1	-1.7	-14.3	-13.2
NASDAQ Composite	1396.6	-2.4	-28.4	-30.6
S&P MidCap 400	437.5	-0.8	-13.9	-11.7
S&P SmallCap 600	200.9	-0.6	-13.5	-10.2
Wilshire 5000	8562.7	-1.3	-20.0	-19.0

SECTORS

	DEC. 11	WEEK	% CHANGE YEAR TO DATE	LAST 12 MONTHS
BusinessWeek 50*	558.1	-0.9	-23.5	-22.7
BusinessWeek Info Tech 100**	298.1	-3.4	-28.9	-31.0
S&P/BARRA Growth	467.0	-1.6	-21.5	-21.1
S&P/BARRA Value	434.8	-1.2	-21.2	-20.2
S&P Energy	185.4	0.7	-12.2	-7.4
S&P Financials	305.2	-1.1	-14.1	-12.7
S&P REIT	90.6	-0.4	-3.0	-2.5
S&P Transportation	172.7	0.5	-12.3	-10.5
S&P Utilities	94.3	2.5	-35.4	-31.4
GSTI Internet	79.3	-3.4	-24.4	-27.6
PSE Technology	476.3	-2.5	-30.7	-32.9

*Mar. 19, 1999 = 1000

**Feb. 7, 2000 = 1000

BEST-PERFORMING GROUPS

	LAST MONTH %	LAST 12 MONTHS %
Paper Packaging	29.1	33.4
Computer Stores	27.8	23.4
Telecomms. Equipment	21.1	21.4
Computer Stge & Perphs.	18.2	15.8
Office Electronics	17.7	15.7

EQUITY FUND CATEGORIES

	4-WEEK TOTAL RETURN %	52-WEEK TOTAL RETURN %
LEADERS		
Natural Resources	5.6	54.0
Technology	4.8	4.5
Small-cap Value	4.7	0.1
Small-cap Blend	4.4	-2.9
LAGGARDS		
Japan	-0.8	-41.3
Europe	-0.8	-39.9
Foreign	-0.3	-26.9
Precious Metals	-0.3	-24.5

EQUITY FUNDS

	4-WEEK TOTAL RETURN %	52-WEEK TOTAL RETURN %
LEADERS		
Firsthand Tech. Innovators	15.3	89.7
Nevis	14.9	73.8
Strong Multi Cap Value	13.7	71.9
New York Equity	13.3	69.4
LAGGARDS		
American Heritage	-30.0	-76.5
ProFunds UltraSh. OTC Inv.	-9.7	-69.7
Rydex Dynam. Vent. 100	-9.6	-68.7
Frontier Equity	-8.7	-67.1

GLOBAL MARKETS

	DEC. 11	WEEK	% CHANGE YEAR TO DATE
S&P Euro Plus (U.S. Dollar)	855.5	-1.5	-20.9
London (FT-SE 100)	3974.9	-1.8	-23.8
Paris (CAC 40)	3190.1	-0.3	-31.0
Frankfurt (DAX)	3196.1	-3.8	-38.1
Tokyo (NIKKEI 225)	8727.7	-3.1	-17.2
Hong Kong (Hang Seng)	9784.6	-2.1	-14.1
Toronto (S&P/TSX Composite)	6587.3	-0.4	-14.3
Mexico City (IPC)	6135.4	-0.8	-3.7

FUNDAMENTALS

	DEC. 10	WK. AGO	% CHANGE
S&P 500 Dividend Yield	1.75%	1.72%	
S&P 500 P/E Ratio (Trailing 12 mos.)	29.5	29.9	
S&P 500 P/E Ratio (Next 12 mos.)*	16.4	16.7	
First Call Earnings Revision*	-2.02%	-2.40%	

*First Call

TECHNICAL INDICATORS

	DEC. 10	WK. AGO	% CHANGE
S&P 500 200-day average	976.7	982.3	
Stocks above 200-day average	28.0%	28.0%	
Options: Put/call ratio	0.76	0.70	
Insiders: Vickers NYSE Sell/buy ratio	1.97	1.70	

WORST-PERFORMING GROUPS

	LAST MONTH %	LAST 12 MONTHS %
Agricultural Products	-9.6	-7.0
Distillers & Vintners	-8.4	-5.0
Health-Care Services	-7.0	-5.0
Environmental Services	-6.2	-5.0
Tobacco	-4.3	-5.0

INTEREST RATES

KEY RATES

	DEC. 11	WEEK AGO	YEAR AGO
MONEY MARKET FUNDS	1.11%	1.14%	2.07%
90-DAY TREASURY BILLS	1.19	1.21	1.67
2-YEAR TREASURY NOTES	1.85	1.98	2.94
10-YEAR TREASURY NOTES	4.02	4.15	4.98
30-YEAR TREASURY BONDS	4.88	5.00	5.46
30-YEAR FIXED MORTGAGE†	6.02	6.08	7.07

†BancQuote, Inc.

BLOOMBERG MUNI YIELD EQUIVALENTS

Taxable equivalent yields on AAA-rated, tax-exempt municipal bonds, assuming a 30% federal tax rate.

	10-YR. BOND	30-YR. BOND
GENERAL OBLIGATIONS	3.91%	4.77%
TAXABLE EQUIVALENT	5.59	6.81
INSURED REVENUE BONDS	4.05	5.00
TAXABLE EQUIVALENT	5.79	7.14

THE WEEK AHEAD

CONSUMER PRICE INDEX Tuesday, Dec. 17, 8:30 a.m. EST ► Consumer prices for goods and services very likely rose 0.2% in November. That's based on the median forecast of economists surveyed by MMS International. Minus food and energy, core inflation probably grew 0.2% as well.

NEW RESIDENTIAL CONSTRUCTION Tuesday, Dec. 17, 8:30 a.m. EST ► Housing starts during November very likely picked back up to an annual rate of 1.66 million.

INDUSTRIAL PRODUCTION Tuesday, Dec. 17, 9:15 a.m. EST ► Factory output in November

is forecast to have slipped 0.1%, after a 0.8% fall in the prior month. The average operating rate most likely inched up to 75.4% from 75.2% in October.

INTERNATIONAL TRADE Wednesday, Dec. 18, 8:30 a.m. EST ► The foreign trade deficit probably narrowed to \$37.8 billion in October, from \$38 billion in September.

LEADING INDICATORS Thursday, Dec. 19, 10 a.m. EST ► The Conference Board's index of leading indicators most likely rose 0.4% in November.

FEDERAL BUDGET Thursday, Dec. 19, 2 p.m. EST ► The federal government is expected report a deficit of \$60 billion for November.

The BusinessWeek production index held steady in the week ended Nov. 30 at 162.9, up 2.1 from a year ago. More complete information available at www.businessweek.com.

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For the BW 50, more investment data, and the components of the production index visit www.businessweek.com



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POLITICS MASQUERADING AS ECONOMICS

An important debate in Washington over how best to structure a tax cut to support a fragile economic recovery is fast devolving into a political slugfest between ideologues. Republican supply siders demanding big, permanent tax cuts are attacking deficit hawks in the GOP and Democratic Party. President George W. Bush's new appointee, CSX Corp. Chairman John W. Snow for Treasury Secretary and former Goldman, Sachs & Co. co-director Stephen Friedman, his expected choice for National Economic Council head, have already become ensnared. To anyone who values pragmatic solutions over ideology—and that includes most businesspeople—the ferocity of debate going on inside the Beltway casts more heat than light (page 28).

Both sides of the debate share the same goal: to promote economic growth and prosperity. Those who want to make permanent the \$1.3 trillion in tax cuts on income and inheritance think budget deficits will take care of themselves. When people receive more of their earned income, they're more productive, the economy grows, and higher tax revenues fill government coffers. Tax cutters believe that higher deficits do not automatically lead to higher interest rates and point to the Reagan years in the '80s and the two years under George W. Bush as proof. Rates fell even as deficits rose sharply.

Deficit hawks disagree. They point out that President Bill Clinton raised the top marginal rates on income taxes, and the economy boomed, much to the chagrin of supply-side tax cutters. Higher taxes combined with robust growth generated tax revenues that turned Ronald Reagan's big budget deficits into surpluses. This lowered interest rates and transferred capital from public to private use. CEOs and investors

prospered from capital gains and stock options, while real wages rose for employees.

The truth is, neither side can prove that its argument is correct. In the end, this supposedly economic debate is really an ideological one. It isn't about which fiscal tools are most effective in stimulating growth but about the role and size of government in the economy and society. What we're really seeing is politics masquerading as economics.

We prefer the sensible center in this debate. We think the economy needs significant tax cuts in the months ahead, especially given the geopolitical uncertainties America faces. Moving the 2004 and 2006 tax cuts forward and ending the double taxation of dividends are good ideas. A six-month payroll tax holiday for both employers and employees would also provide a strong fiscal kick.

We do worry about the long-term deficit. The disappearance of a \$5.7 trillion surplus overnight shows how little anyone really knows about the economy and budgets. Back then, no one realized how dependent federal and state budgets had become on the stock market. Today, we don't know what the real cost of battling terrorism will be. Terrorism raises the risk factor, we don't know by how much. We also don't know the cost of war in the Middle East. If the U.S. is serious about spreading democracy and modernity throughout the Mideast, it could cost \$1 trillion. Finally, we worry about the real cost of baby boom retirement. Washington is in denial on this.

It just makes sense given all the uncertainties that we choose a prudent and practical, not ideological and political. Tax policy shaped by the desire to reelect a President or to further political agendas isn't what's best for the nation. Let's be honest about this.

WINNING HEARTS AND MINDS IN THE MIDEAST

Battles are won by brave warriors wielding powerful weapons, using smart strategies during relatively brief engagements. Wars, however—especially wars to replace dictatorships with democracy, fear with personal freedom, and state control with private markets—are won by mass mobilizations of large populations around a larger purpose over a long period of time. In Afghanistan, President Bush showed that he can lead the nation successfully into battle, and there is little doubt that he can do that again in Iraq. But the President has not shown much willingness to mobilize the American people for a long and costly fight against terrorism. He has yet to make the case that Iraq is behind terrorism or that it has weapons of mass destruction. And he has yet to mobilize the masses in the Middle East around a post-Saddam vision of a U.S.-led renaissance of Arab society based on modernity, opportunity, and prosperity.

Unless the President remedies this, the U.S. risks a pun-

ishing blowback from an Iraq invasion that might increase, not decrease, terrorist attacks and antagonize rather than attract the very people it intends to help in the Middle East. Afghanistan, where the U.S. won the battle against the Soviets and then abandoned the country, the Taliban and Osama bin Laden rose out of the ashes to kill thousands on American soil on September 11. This cannot be repeated (page 44).

President Bush must first reveal evidence that Iraq possesses weapons of mass destruction. Then he should cut U.S. dependence on Middle East oil by insisting, in the name of national security, that Detroit raise mileage requirements for U.S. cars. Finally, he should commit the U.S. to a long-term war supporting secular moderates against Islamic fanaticism. This also means reengaging in the Israeli-Palestinian conflict to forcefully shape a settlement.

A battle with Iraq may well be the easy part. The real challenge will be for the values of Middle Eastern societies.

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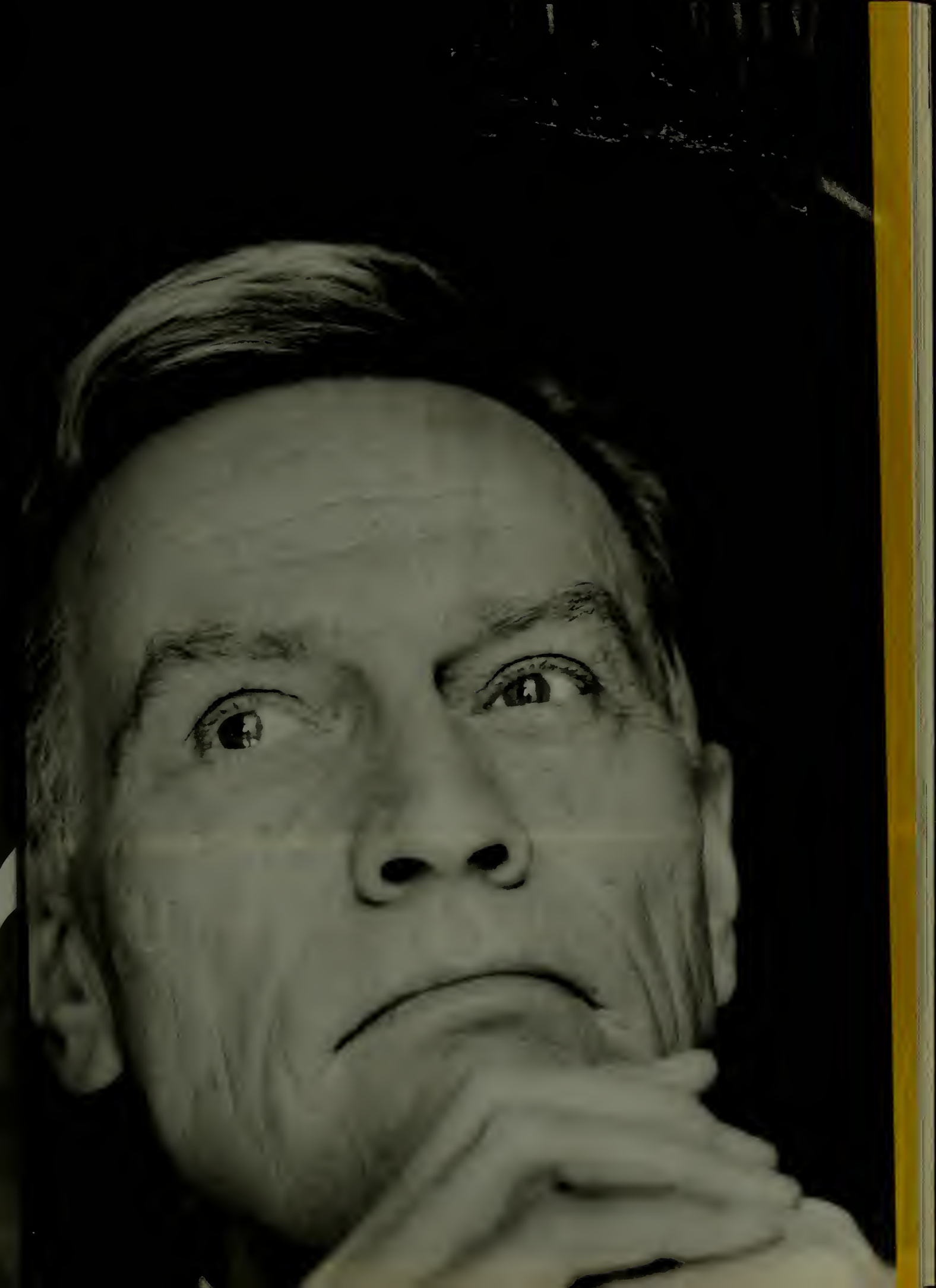
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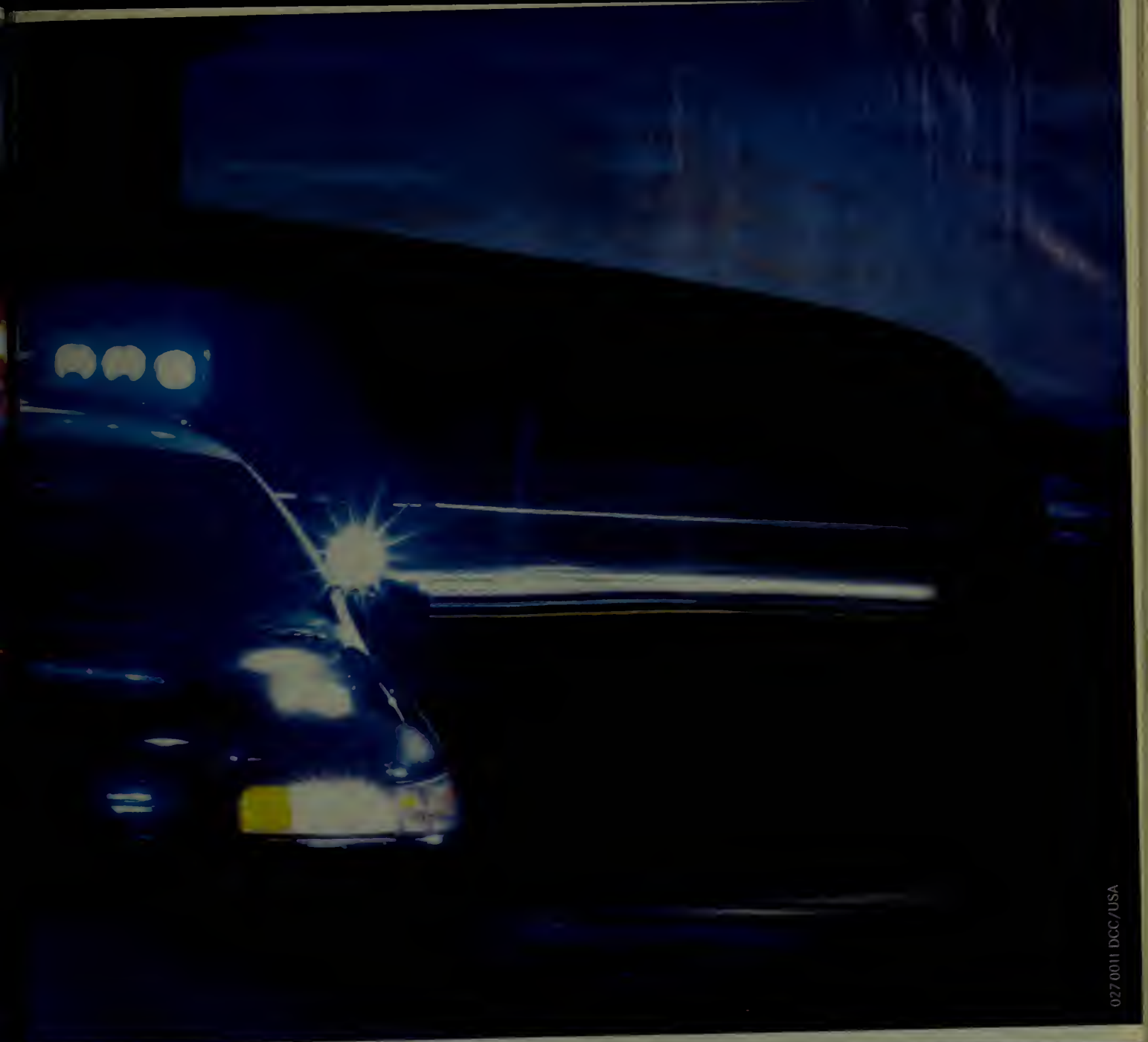




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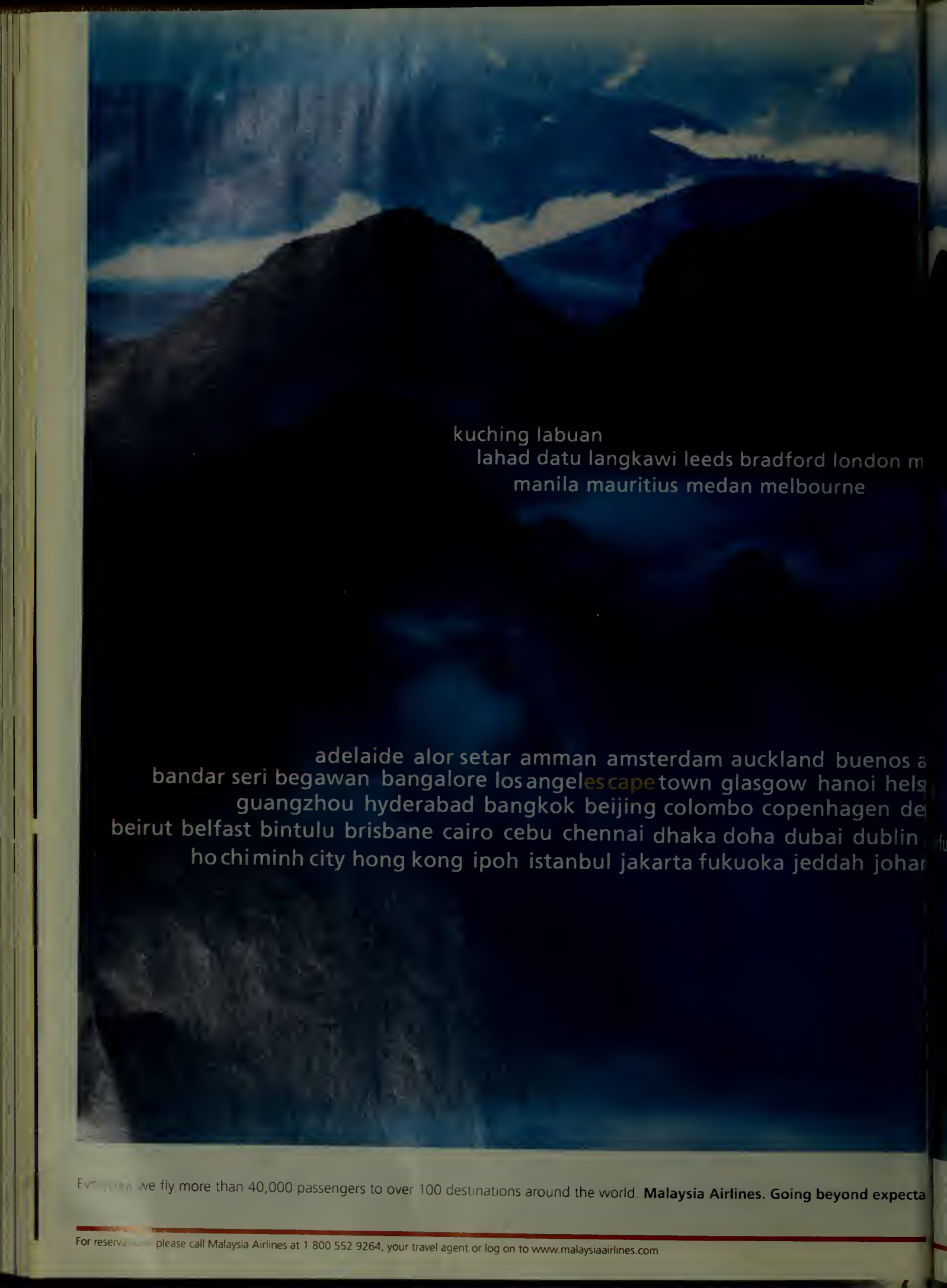
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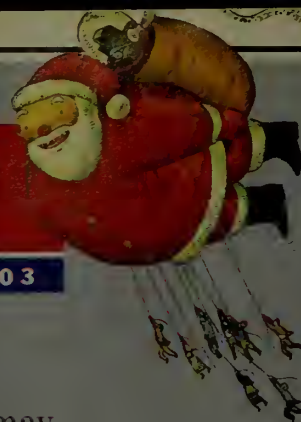


Our Challenge is Life



BusinessWeek

DECEMBER 30, 2002 / JANUARY 6, 2003



SNOW JOB

Net stocks' holiday highs may not outlast the eggnog
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Protectionism r
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GREAT DEBATE

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A Love/Hate Story

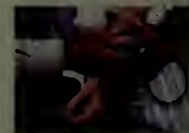
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Up Front

EDITED BY SHERIDAN PRASSO



BANKRUPTCY BRIEFS

AT UNITED, A LOCK ON STOCK SALES

WHEN ENRON WENT BUST, some of the loudest cries came from employees barred from selling their stock. Today, it's workers at United Airlines who are howling.

A day after UAL filed for Chapter 11, United won a court order that blocks large shareholders from unloading stock. The manager of United's 401(k) program, Aon Fiduciary Counselors, beat the cutoff: It got rid of all 12.7 million UAL shares it had

held for employees. But 75,000 workers and retirees with shares in United's employee stock ownership plan are stuck. The ESOP manager, State Street Bank & Trust, sold 24.1 million UAL shares ahead of the filing but still owns 32.5 million. On Dec. 17, State Street went to court to get the no-sale order lifted—and lost.

United insists it isn't trying to hurt anyone. Instead, it says it's protecting federal tax breaks worth \$1.4 billion. How's that? Under the tax code, the breaks would be voided if any big shareholder sells out. *Michael Arndt*

ESTATE TAXES

LOOK WHO SAYS 'SOAK THE RICH'

THE PROGRESSIVE-TAX CROWD has an unlikely champion: the father of the world's wealthiest man. Attorney William Gates Sr. recently chaired a committee aimed at improving Washington State's tax code. The finding: Shift the burden more to the wealthy by reducing property and sales taxes and imposing state income tax. "The current structure is really unsatisfactory," Gates told the legislature on Dec. 3.

And that's just his opening act. Gates père hits the book circuit soon to promote



GATES AND SON

his upcoming treatise on preserving the estate tax, *Wealth and Our Commonwealth: Why America Should Tax Accumulated Fortunes*. "There is something fundamentally American about the notion that what people do with their lives is more important than the station of birth," he writes. Otherwise, he argues, we could develop

a permanent aristocracy.

What does Gates's son think? "I certainly agree," he says. Gates won't reveal estate plans, except to

say that "the vast majority" will go to his foundation. Even if he left only 1% of assets to his three children, they would still get \$500 million each. *Jay Greene*

TALK SHOW "Venezuela now overshadows the threat from Iraq."

—Phil Flynn, a senior energy trader at Alaron Trading in Chicago, speaking of the potential for oil-supply disruptions

BOARD GAMES

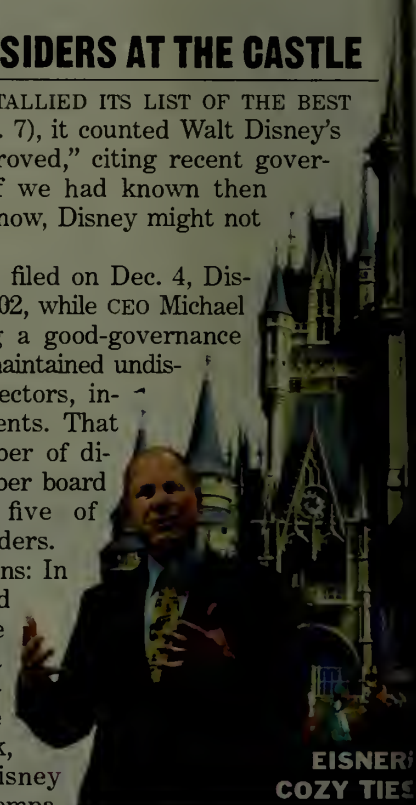
DISNEY: MORE INSIDERS AT THE CASTLE

WHEN *BUSINESSWEEK* TALLIED ITS LIST OF THE BEST and worst boards (Oct. 7), it counted Walt Disney's among the "most improved," citing recent governance changes. But if we had known then some things we know now, Disney might not have fared so well.

In its annual report filed on Dec. 4, Disney revealed that in 2002, while CEO Michael Eisner was promoting a good-governance agenda, the company maintained undisclosed ties to five directors, including two independents. That brings to 11 the number of directors on the 17-member board with company ties, five of whom it considers insiders.

Among the revelations: In 2002, Walt Disney paid \$623,782 to a private company for use of a plane by Vice-Chairman Roy Disney. The company, Air Shamrock, is owned by the Disney family and a holding company run by director Stanley Gold. What's more, Walt Disney disclosed that in 1997 it had pledged \$25 million to the Performing Arts Center of Los Angeles County to build Walt Disney Concert Hall and has donated \$20 million far. The chairman and CEO of the arts center? "Independent director Andrea Van de Kamp, who joined the board year after Disney pledged the cash.

Responding on Disney's behalf, its governance adviser Ira Millstein, says the board should be applauded for making the disclosures, which in most cases were not required. "As long as you tell everybody what you're doing, that's good governance," he says. That's something for Disney shareholders to decide. *Louis Lave*



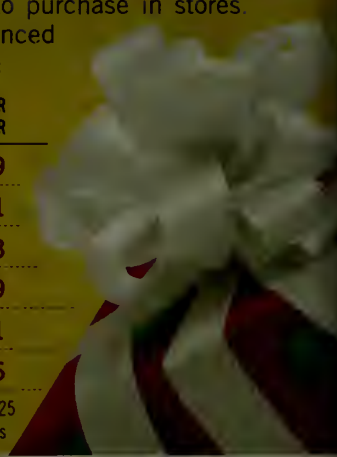
EISNER'S COZY TIES

THE BIG PICTURE: ONLINE FOR THE HOLIDAYS

Holiday shoppers buy online, and they also use the Net to research gifts they plan to purchase in stores. Here's where the Web-influenced spending totals are greatest:

CITY	AMOUNT PER ONLINE SHOPPER
SAN FRANCISCO	\$399
NASHVILLE	\$381
MIAMI	\$353
PHILADELPHIA	\$349
SACRAMENTO	\$341
BALTIMORE	\$336

Online survey of 6,976 adults, released on Nov. 25
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Up Front

THE QUIZ

All those bankruptcies and scandals starting to blur? Take our quiz, and see how much you remember from the year's business news. Get 'em all right, and you win bragging rights.



1 Since World War II, the typical recession has lasted 13 months. The recession that began in March, 2001, came to an end in which month, according to the National Bureau of Economic Research?

- a. December, 2001
- b. March, 2002
- c. June, 2002
- d. September, 2002
- e. The recession has yet to be declared over

2 Which was the first major bankruptcy of 2002?

- a. Adelphia
- b. Kmart
- c. Global Crossing
- d. WorldCom



3 Over the past year, the U.S. economy has continued to see jobs melt away. Which of these sectors defied the trend by adding jobs?

- a. tobacco production
- b. legal services
- c. car dealers
- d. motion pictures
- e. all of the above

4 The résumés of these execs all included degrees that were never earned. Who was forced to give up his job because of the error?

- a. Ram Kumar, analyst, Institutional Shareholder Services
- b. Bryan Mitchell, CEO, MCG Capital
- c. Ronald Zarrella, CEO, Bausch & Lomb
- d. Mitchell and Zarrella
- e. all of the above



5 Which of the following is not known to be an Enron trading strategy?

- a. Death Star
- b. Ricochet
- c. Skywalker
- d. Fat Boy

6 The federal judge overseeing several private lawsuits against Microsoft compared the company's behavior to that of:

- a. Machiavelli's Prince
- b. Shakespeare's Shylock
- c. Allen Iverson
- d. Tony Soprano
- e. Tonya Harding

7 About what percentage of large companies have said they will expense stock options by October, 2003?

- a. 3
- b. 8
- c. 22
- d. 31

8 Sam Waksal, former Imclone Systems CEO, is accused of helping others illegally trade Imclone shares. Whom is he charged with helping?

- a. his father and daughter
- b. his father, daughter, and Martha Stewart
- c. his father, daughter, and a Merrill Lynch broker
- d. all of the above

9 Which of these has the highest market cap?

- a. Amazon
- b. eBay
- c. Federated Dept. Stores
- d. Southwest Airlines

10 At the time of the affair that ended his second marriage, which of these was not a retirement perk of former General Electric CEO Jack Welch?

- a. flowers
- b. wine
- c. N.Y. Rangers tickets
- d. opera tickets
- e. discounted diamonds

11 New York State Attorney General Eliot Spitzer charges that Merrill Lynch promoted seven Internet companies in public while

disparaging them in e-mails. Merrill made its highest rating to how many of them?

- a. 1
- b. 3
- c. 5
- d. 7

12 Hormone replacement therapy for post-menopausal women has been controversial this year. It is now thought to protect against:

- a. breast cancer
- b. osteoporosis
- c. Alzheimer's disease
- d. heart disease
- e. none of the above

13 Which of these executives were indicted in 2002?

- a. Bernard Ebbers, former WorldCom CEO
- b. Andrew Fastow, former Enron CFO
- c. Jack Grubbs, former Salomon Smith Barney
- d. Martha Stewart
- e. Scott Sullivan, former WorldCom CEO
- f. Mark Swartz, former Tyco



14 Since 1982, eight airlines besides United have filed for bankruptcy. Based on the experiences of the eight, what are the chances United will file for bankruptcy a second time?

- a. 13%
- b. 25%
- c. 50%
- d. 63%

NUMBERS GAME

15 Match the household item with the amount Tyco paid for it, on behalf of ex-CEO

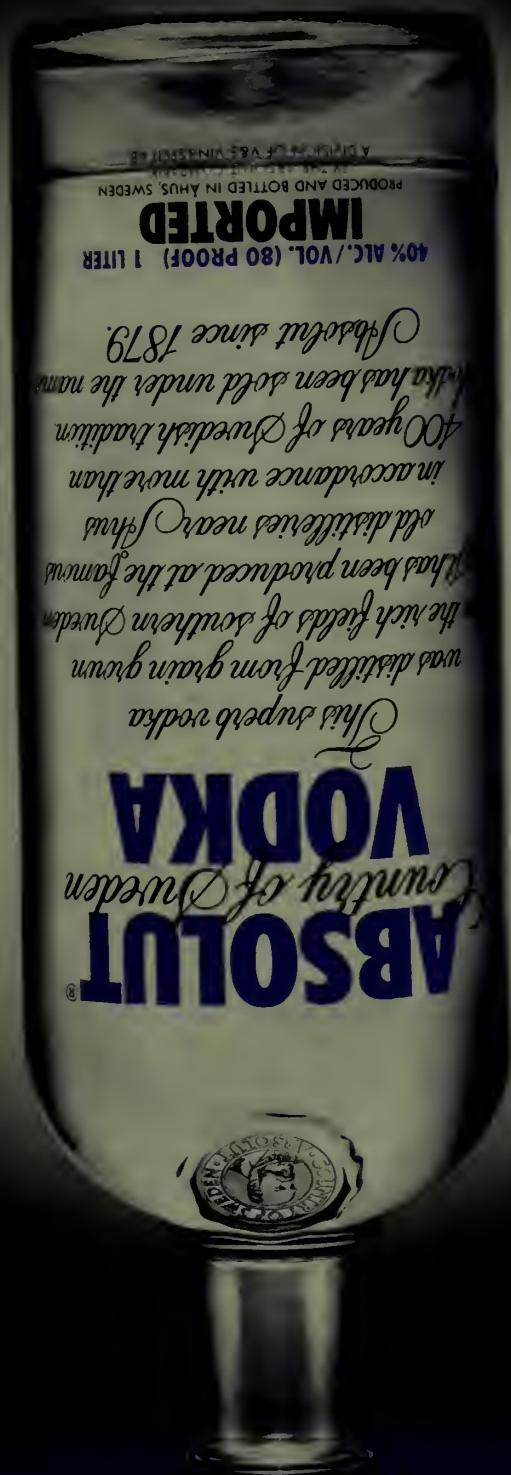
Dennis Kozlowski:

- a. umbrella stand
- b. shower curtain
- c. notebook
- d. wastebasket
- e. sewing basket
- f. pincushion

- 1. \$6,000
- 2. \$1,650
- 3. \$445
- 4. \$6,300
- 5. \$15,000
- 6. \$2,200



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THE MEANING OF THE KEN LIPPER SAGA

A sizable portion of "The fallen financier" (Cover Story, Dec. 9) dealt with what Ken Lipper knew and when he knew it—relative to the law. I believe that Ken Lipper is guilty of a far greater crime: The courts will wrangle over legal questions, but it is clear that Ken Lipper has dishonored his own name.

There was a time when putting your name on the door of a business meant personally taking responsibility for its actions. I believe most people in business still adhere to this time-honored standard.

Whether Lipper knew what his traders were doing—he should have—is immaterial. It happened on his watch at his company under his name. That should stand for something.

Michael Atherton
Arlington, Va.

"The fallen financier" was an extreme example of *schadenfreude*. I have known Kenneth Lipper since the late 1970s at Salomon Brothers. I remember being on the trading desk when the stock-buying blitz of Becton, Dickinson & Co. that Ken helped to complete occurred. It was called LHW ("let's hope it works"). There may have been an attempt to push the limits of the Securities & Exchange Commission rules at that time, but there wasn't any illegal intent. Similarly, Ken may have miscalculated the hedging strategy using convertible bonds, but it is unlikely that he intended any fraudulent activity, particularly if his own family funds were

invested along with his clients' funds. Investors had a right to rely on experience, and most sophisticated investors understand that high returns involve high risk. Clearly, the real role was to be on the firing line. The management was left to Ken. The financial losses are serious, and the emotional impact is understandably difficult, but let's wait to hear the legal details of Lipper & Co. before we heap blame on an accomplished individual.

Steven A. Lipp
New York

I worked as a high-yield-bond analyst and trader at Lipper & Co. from 1993 to 1995 and was shocked to read about the firm's recent closing. What I witnessed was a disciplined approach to investing—with genuine concern shown for investors' assets. All analysts and traders were required to arrive

by 7:30 in the morning, read three newspapers, and remain abreast of all developments. Lengthy meetings were held to discuss any new investment idea. Ken Lipper encouraged employees to act as a team, and unprofessional behavior was not accepted. Yet, out of the strict "Wall Street" atmosphere, Ken always made me feel I was part of a family. I have nothing but fond memories of the people at Lipper & Co.

Charles Keiser
Chicago

THE NEW PHILANTHROPY: WHAT GIVES?

"The new face of philanthropy" (Cover Story, Dec. 2) gave me hope for the future. But the feeling of hope did



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Readers Report

CORRECTIONS & CLARIFICATIONS

In "FedEx: Gaining on the ground" (The Corporation, Dec. 16), a table accompanying the story should have listed 2001 profits for FedEx of \$584 million, not \$1 million, and should have said the share of operating profits from ground shipments in 2001 was 16.3%, not 14.7%. Also, the company now says that it has spent a total of \$3 billion over the past five years to build up its ground service, including freight delivery. *BusinessWeek* reported that FedEx spent \$1.2 billion, based on an analyst's estimate for parcel-delivery operations alone.

In "Which adviser knows the way?" (*BusinessWeek* Investor, Nov. 25), we should have noted that in July, 2000, the curriculum for the Chartered Financial Consultant (ChFC) designation was changed so that it is now similar to that of the Certified Financial Planner (CFP) designation.

last long. It was replaced with only one question: What about the people in America who are destitute and unnamed with no "foundation" behind them? I found many worthy humanitarian causes with global reach, yet I found few causes listed that would perhaps help the poor and destitute of America.

Why must philanthropy be used for "creating a community foundation to fund already successful nonprofit leaders as they expand the scale and scope of their operations" rather than giving directly (not blindly) to organizations that would not have to market themselves?

Charlotte Cox
Phoenix

As a longtime subscriber to *BusinessWeek*, I am compelled to respond to your excellent article, up to and excluding "possible philanthropic laggards" and your search for them in the "public records." What part of "private" and "anonymous" do you not understand? How dare you vilify people who want to do good works in private?

Chris Horne
Arlington, Va.

GET OFF THE GOLF COURSE, TECH INVESTORS

Hooray for Robert D. Hof telling it like it is ("The kick in the pants that tech needs, News: Analysis & Commentary, Dec. 9). Venture capitalists and "angel investors" have abandoned the market and are hiding out on golf courses. The really sad part is that they

continue to encourage early startups to waste valuable resources and time on funding pitches they have no intention of considering. I wonder how many early-stage startups have failed just jumping through hoops that angel groups and VCs continue to encourage?

Patrick Kearns
Cardiff, Calif.

WHAT ROBERT BARRO DOESN'T KNOW ABOUT DOCKWORKERS

Robert J. Barro characterizes the International Longshore & Warehouse Union's workers as "semi-skilled" ("The best little monopoly in America," *Economic Viewpoint*, Dec. 9). With respect, it's obvious he has never set foot on a West Coast dock—where he would have witnessed a highly skilled and thoroughly trained workforce operating computerized cranes and various other sophisticated and often dangerous cargo-moving equipment.

As for having the muscle to damage the U.S. economy, Barro could have been more generous and shared some of his accolades with the Pacific Maritime Assn. After all, it was the PMA that exercised its muscle in locking out the ILWU in their recent contract dispute.

Richard S. Adams
Willard, Mo.

SLURS FELL ON ALABAMA

Having grown up in Alabama, I was taken aback to read in "The populist on the banking committee" (*Finance*, Dec. 2) that Richard C. Shelby "hails from a state that has no big financial institutions."

Last time I checked, three of the country's 25 biggest commercial banks were headquartered in Alabama. Hardly the stuff of free toasters.

Dave Benditt
Kansas City, Mo.

A FAITHFUL READER SPOTS AN EVERGREEN IDEA

When I read "Productivity gains: The good news and the good news" (*Business Outlook*, Nov. 25), I was reminded that some 30 years ago, while riding to work on the South Shore train from Indiana to Chicago, I read a *BusinessWeek* article on the importance of productivity to our economy. I agreed with the article then...so much so that I wrote a letter to your editor (not published). It's interesting to note that certain economic principles survive the

"test of time," as I agree with the recent article more than ever.

Dan Molinaro
Houston

NO SKIRTING THE RULES TO SELL TECH IN CHINA

I believe there was a misunderstanding in "High tech in China" (Cover Story, Oct. 28), implying that Semiconductor Manufacturing International Corp. (SMIC) engineers can tinker with the chipmaking equipment to "skirt the ban" on the sale of advanced technology to China. That is not what I said. I was talking about the possibility of our engineers making smaller transistors by adjusting their process-engineering methods. SMIC does not modify equipment to circumvent regulations. We strictly follow conditions prescribed by governing authorities.

Joseph Xie
Senior Director for
Business Development
SMIC
Shanghai

GIVE THE ACCOUNTANTS MORE CREDIT

On behalf of the American Institute of Certified Public Accountants (AICPA), I take exception to "So much for cracking down on the accountants" (*Economic Viewpoint*, Nov. 18). Several of Robert Kuttner's points are in error. First, the Financial Accounting Standards Board defines accounting standards, not auditing standards as Mr. Kuttner stated. Auditing standards have long been the responsibility of the AICPA's Auditing Standards Board, which reflects a wide cross-section of the accounting profession and its most highly regarded professionals. With the passage of the Sarbanes-Oxley Act, standard-setting now rests with the new Public Company Accounting Oversight Board, which has been given broad latitude in determining the best way to set standards going forward. The AICPA has always espoused broad public participation in setting standards, to strengthen its own standard-setting capability, and is redoubling efforts to encourage the participation of institutional investors and other users of financial statements in its process.

Second, the accounting profession did not resist the recommendations of the 2000 Audit Effectiveness panel, as Kuttner asserts. In fact, the AICPA used those recommendations to help frame a new fraud standard (Statement on Auditing Standards No.99) that makes

andatory procedures to be performed every audit engagement to help detect fraud.

Contrary to Kuttner's assertion that the accounting profession is attempting to reverse reform by stealth," the profession is fully committed to implementing the Sarbanes-Oxley Act. We believe that a new discipline model for our members is critical and that an independent body is the best way to achieve this. In fact, the accounting profession has been calling for an independent oversight board since last January. Finally, Kuttner charges that "the CPA spent only a few million dollars a year on self-policing." During fiscal year 2002, we spent \$10.7 million on SEC Practice Section peer reviews, ethics investigations, and Trial Board activities.

Linda E. Dunbar
Director of Public Relations

AICPA
New York

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WORLD ON FIRE

How Exporting Free Market Democracy Breeds Ethnic Hatred and Global Instability

By Amy Chua

Doubleday • 340pp • \$26

IS DEMOCRACY DANGEROUS?

America's prescription for developing nations is simple: democracy and free-market capitalism. But what if these ideas turn out to be like medicines that produce nasty side effects when taken in combination? There you have the theme of the fascinating and disturbing *World on Fire: How Exporting Free Market Democracy Breeds Ethnic Hatred and Global Instability*.

It would be easy to dismiss this as yet another attack on globalization. But this book is hardly that. Author Amy Chua understands the economics of developing nations: The 40-year-old Yale Law School professor served a stint at the World Bank, worked for four years on Wall Street, and helped privatize the state-owned Teléfonos de México. Chua sees no inherent evil in capitalism, thinks representative democracy is a good thing, and writes with an authority born of rigorous research.

Yet Chua warns that the phenomenon of "market-dominant minorities"—taken in combination with globalization and democracy—can cause huge strains in the developing world. Chua chillingly describes how, in 1994, her Aunt Leona, a Chinese businesswoman in the Philippines, was stabbed to death by her chauffeur. Despite eyewitness accounts by other servants, there were no arrests. Why not? Ethnic Chinese, at just 1% of the Philippines population, control 60% of its wealth. Meanwhile, two-thirds of the 80 million ethnic Filipinos live on less than \$2 a day. Chua shows how her aunt's murder was part of a pattern of violence against Chinese, noting that police in such cases are "notoriously unmotivated" to seek justice.

In fact, in the police report of the case, under the section on motive, is written: "revenge." But as Chua makes clear, when economic inequality is laced

with other factors, existing hostilities are exacerbated. Free-market policies often concentrate wealth in the hands of the tiny business elites that dominate many developing nations. Toss democracy into the fermenting brew, and the oppressed majority is emboldened to strike the rich few, particularly if they are an easily identified ethnic group. That's what occurred in the Philippines after the alliance between the ethnic Chinese and dictator Ferdinand Marcos was broken by Marcos' exile and the arrival of democracy. In Indonesia, the end of Suharto's dictatorship in 1998 saw the looting and burning of 5,000 shops and houses of ethnic Chinese in Jakarta. The Lebanese in West Africa, Asian Indians in East Africa, Jews in Russia, and whites in Zimbabwe have all suffered after democratic rule arrived. "The competition for votes fosters the emergence of demagogues who scapegoat the resented minority, demanding an end to humiliation, and insisting that the nation's wealth be reclaimed by its 'true owners,'" says Chua.

No two countries are precisely the same, of course. But it's remarkable how many developing nations are affected by the perilous mixture the author describes. In Nigeria—a free-market country that is constantly experimenting with (and failing at) democratic rule—tens of thousands of the indigenous Ibo tribe have been slaughtered by their poorer but more numerous tribal rivals. In Rwanda, the Tutsi tribe held the political and economic reins until far-more-numerous Hutus murdered hundreds of thousands of them in the '90s.

In Zimbabwe, a regime set up by

European colonialists gave way to democratic institutions in 1980. Today, Zimbabwean President Robert Mugabe maintains his political power by urging his fellow veterans of the liberation struggle to throw whites off their land by force. In Kenya, a tiny Indian hangs on, "uncomfortably dependent on the corrupt and increasingly authoritarian President [Daniel Arap] Moi." African opposition leaders intensify their ethnic hatemongering," says Chua.

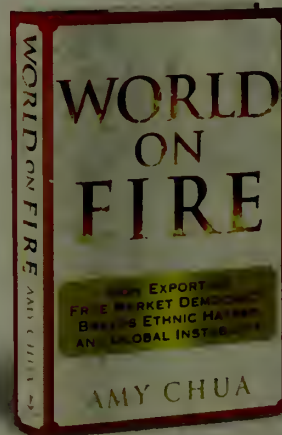
The pattern of market-dominant ethnic minorities holds true in much of South America as well as in Southeast Asia, Africa, the former Yugoslavia, Russia, although not in China thanks to intermarriage between Tibetans and Chinese—in Thailand. Similarly, Argentina, Uruguay, and Chile have been spared. (Their troubles occurred earlier: Indigenous Amerindian people were killed off by the Conquistadors.) And the phenomenon is almost entirely absent in Arab nations.

Chua was writing the book when terrorists slammed planes into the World Trade Center and the Pentagon on September 11, 2001. Americans were shocked at the number of those in poorer nations who rejoiced. Chua's partial explanation: "America too has become the world market-dominant minority... seen (not incorrectly) as the engine and principal beneficiary of globalization." September 11 was "an act of revenge by the weak against the powerful, motivated by tremendous feelings of humiliation and inferiority."

Mercifully, Chua doesn't try to solve all the world's problems in a glib "solutions" chapter, nor does she think that more democracy is the solution. Her best suggestions: Cushion the impact of globalization with progressive government tax and transfer programs, encourage greater small-business growth and wider stock ownership, and, above all, go slow, and respect local customs. The U.S. didn't become a free-market democracy overnight, and it shouldn't expect the same of others.

BY PAUL MAGNUSSON

Magnusson covers international trade and economics from Washington.



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2	WHO SAYS ELEPHANTS CAN'T DANCE? Louis V. Gerstner Jr. (HarperBusiness • \$27.95) <i>The turnaround at IBM, by the company's ex-CEO.</i>	—	1		2	THE TIPPING POINT Malcolm Gladwell (Back Bay • \$14.95) <i>What turns an idea into a hot trend, by a New Yorker writer.</i>	2	1	
3	GOOD TO GREAT Jim Collins (HarperBusiness • \$27.50) <i>How run-of-the-mill companies make the leap to excellence.</i>	2	14		3	REAL ESTATE RICHES Dolf de Roos (Warner • \$17.95) <i>Why buildings are better investments than stocks.</i>	3	1	
4	EXECUTION Larry Bossidy, Ram Charan (Crown Business • \$27.50) <i>Making strategies work.</i>	5	6		4	WHAT COLOR IS YOUR PARACHUTE? Richard Nelson Bolles (Ten Speed • \$17.95) <i>The 2003 edition of the enduring job-search bible.</i>	5		
5	TAKE ON THE STREET Arthur Levitt, with Paula Dwyer (Pantheon • \$24.95) <i>The former SEC chairman on accounting sleight of hand and wise investing.</i>	4	2		5	THE RICHEST MAN IN BABYLON George S. Clason (Signet • \$6.99) <i>Save 10% of what you earn—then pay your bills.</i>	6		
6	THE ONE-MINUTE MILLIONAIRE Mark Victor Hansen, Robert G. Allen (Harmony Books • \$19.95) <i>Chicken soup for the investor.</i>	6	2		6	THE E-MYTH REVISITED Michael E. Gerber (HarperBusiness • \$16) <i>A systems approach for small-business success.</i>	7	1	
7	MEMOIRS David Rockefeller (Random House • \$35) <i>The banker-statesman's life and times.</i>	8	2		7	RICH DAD'S RETIRE YOUNG RETIRE RICH Robert T. Kiyosaki, with Sharon L. Lechter (Warner • \$17.95) <i>Plan ahead.</i>	4	1	
8	RICH DAD'S PROPHECY Robert T. Kiyosaki, with Sharon L. Lechter (Warner • \$21.95) <i>Coming soon—a very big crash!</i>	3	2		8	THE 9 STEPS TO FINANCIAL FREEDOM Suze Orman (Three Rivers • \$13.95) <i>Stop worrying and learn how to manage your money.</i>	8	2	
9	DILBERT AND THE WAY OF THE WEASEL Scott Adams (HarperBusiness • \$24.95) <i>Scheming, manipulating, fudging, and other fun at the office.</i>	14	2		9	J.K. LASSER'S YOUR INCOME TAX 2003 J.K. Lasser Institute (Wiley • \$16.95) <i>Warm up your calculator.</i>	—		
10	NOW, DISCOVER YOUR STRENGTHS Marcus Buckingham, Donald O. Clifton (Free Press • \$27) <i>How to bolster your true talents.</i>	7	23		10	THE POWER OF FOCUS Jack Canfield, Mark Victor Hansen, Les Hewitt (Health Communications • \$12.95) <i>Success without burnout.</i>	12		
11	THE FIVE DYSFUNCTIONS OF A TEAM Patrick Lencioni (Jossey-Bass • \$22) <i>Overcoming behavior that obstructs teamwork.</i>	11	7		11	OWN YOUR OWN CORPORATION Garrett Sutton, Esq. (Warner • \$17.95) <i>The legal ins and outs of establishing a company.</i>	10		
12	PRIMAL LEADERSHIP Daniel Goleman, Richard Boyatzis, Annie McKee (Harvard Business School • \$26.95) <i>Using "emotional intelligence" as a leadership tool.</i>	12	9		12	START YOUR OWN BUSINESS Rieva Lesonsky (Entrepreneur Press • \$24.95) <i>Lemonade, anyone?</i>	—		
13	THE 21 IRREFUTABLE LAWS OF LEADERSHIP John C. Maxwell (Thomas Nelson • \$22.99) <i>A minister's down-to-earth rules.</i>	—	22		13	HOW TO MAKE MILLIONS IN REAL ESTATE IN 3 YEARS STARTING WITH NO CASH Tyler G. Hicks (Berkely • \$14) <i>Make way, Donald Trump!</i>	—		
14	WEALTH AND DEMOCRACY Kevin Phillips (Broadway • \$29.95) <i>How the rich get richer: politics.</i>	—	5		14	THE OTHER 90% Robert K. Cooper (Three Rivers Press • \$14) <i>Practical steps for living up to your potential.</i>	—		
15	YOU GOT SCREWED! James J. Cramer (Simon & Schuster • \$20) <i>A television commentator's take on the corporate scandals.</i>	—	1		15	HOME BUYING FOR DUMMIES Eric Tyson, Ray Brown (Wiley • \$21.95) <i>Gimme shelter—and a mortgage.</i>	15		

LONG-RUNNING BEST-SELLERS

HARDCOVER BUSINESS BOOKS

- WHO MOVED MY CHEESE?** Spencer Johnson (Putnam • \$19.95)
- FISH!** Stephen C. Lundin, Harry Paul, John Christensen (Hyperion • \$19.95)
- FIRST, BREAK ALL THE RULES** Marcus Buckingham, Curt Coffman (Simon & Schuster • \$27)
- RAVING FANS** Ken Blanchard, Sheldon Bowles (Morrow • \$20)

PAPERBACK BUSINESS BOOKS

- RICH DAD, POOR DAD** Robert T. Kiyosaki, with Sharon L. Lechter (Warner • \$15.95)
- THE 7 HABITS OF HIGHLY EFFECTIVE PEOPLE** Stephen R. Covey (Fireside • \$14)
- RICH DAD'S CASHFLOW QUADRANT** Robert T. Kiyosaki, with Sharon L. Lechter (Warner • \$17.95)

GETTING TO YES Roger Fisher, William Ury, Bruce Patton (Penguin • \$14)

THE ONE MINUTE MANAGER Kenneth Blanchard, Spencer Johnson (Berkely • \$12.95)

RICH DAD'S GUIDE TO INVESTING Robert T. Kiyosaki, with Sharon L. Lechter (Warner • \$19.95)

THE MILLIONAIRE NEXT DOOR Thomas J. Stanley, William D. Danko (Pocket Books • \$7.95)

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BY STEPHEN H. WILDSTROM

tech&you@businessweek.com

GAZING INTO MY CRYSTAL PC...



What's ahead in 2003? A new chip will boost the spread of Wi-Fi, and home networking will come into its own

The year just ended was another rough one for the technology biz. But you can't keep a good industry down. Despite slumping sales, cratering stock prices, and tight-fisted investors, 2002 saw progress and innovation in personal technology that should blossom in 2003.

In 2002, wireless data became a reality. Widely available networks offered speeds equivalent to dial-up. High-speed Wi-Fi wireless networks became available not only in offices and homes but also in "hot spots" at airports, hotels, coffeehouses—even convenience stores. In 2003, these networks should become easier to use, cheaper, and more pervasive, fulfilling the promise of anytime, anywhere connections.

Both the networks and the devices that use them are getting a lot smarter as we move toward the day when your laptop or handheld will automatically use the best available connection—and you'll get a single monthly bill that covers all the networks you use. Those changes are coming quickly as carriers follow the drift of wireless voice service toward flat-rate pricing for different classes of users. For example, a heavy user of wireless data on a laptop might pay \$100 a month, while someone who just checks e-mail on a handheld would get a \$30 account. The software, roaming, and billing systems needed to make seamless network switching a reality remain a formidable challenge. It probably won't come together in 2003, but we are well on the way.

Automatic switching among wireless networks will happen first on laptops since each network requires its own radio, and it's hard to cram all that gear into a package that can fit in a pocket. Wireless laptops will get a big boost when Intel releases the first processor it has designed from the ground up for mobile use rather than scaling one down from a desktop chip.

The still-unbranded Intel chip, code-named Baniyas, should show up in notebooks in early spring. Laptop makers don't want to hear this, but if you're in the market for a new computer and can hold off for a bit, Baniyas is worth wait-

ing for. Intel says early tests show that Baniyas-powered products offer better performance while consuming a lot less power than the current Pentium 4-M. That's more important than ever because wireless communication is a power hog.

Baniyas also is meant for wireless notebooks, and Intel's support chips will make it possible to build Wi-Fi into laptop motherboards. That should help make Wi-Fi so cheap that by the end of next year, it should be standard on nearly every mobile computer. Moving Wi-Fi to the motherboard will let engineers pack more into laptops, say, Bluetooth for short-range wireless modems that link with mobile phone networks.

Another trend that developed more slowly than I expected in 2002 but may take off in the coming year is networked home entertainment. The first devices that let you play digitized music over existing stereo gear were too costly and too inconvenient because they failed to let networks to play music already stored on



hard drives. The coming months will bring wireless products for about \$200 that will let you take recordings off a PC in your den and play them on your stereo in the living room. And wireless networks get faster next year, you will be able to add video to the mix.

Whether this actually happens or not depends less on the technology (which is coming along nicely) than on the willingness of entertainment companies to make their music and films available in digital form. Record companies, battered by illegal downloading of music, are starting to offer their catalogs online at a reasonable cost and with much less fuss. It will be a while before the Internet is fast enough to deliver quality video. But the sorry truth is that we are making a lot more progress on the technology than resolving the fierce legal disputes over copyright protection that now bar the way.

Given the industry's battered state, 2003 is likely to be a year of incremental progress rather than radical breakthroughs. But progress there will be. I want to take this occasion to thank you of my readers and wish you a healthy, prosperous, and peaceful New Year.

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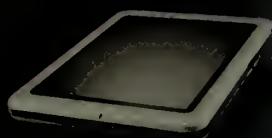
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BY GARY S. BECKER

WHAT THE SCANDALS REVEAL: A STRONG ECONOMY



RESILIENT:
Despite a raft of traumas, the downturn has been mild. Now a hastily passed law on corporate governance could hinder business

The corporate misdeeds during 2002 that involved misleading accounting, false information, and unethical behavior by some executives were deeply embarrassing to American business. Europeans delighted in this apparent indication that American-style competition was inferior to their consensus capitalism. These scandals are deplorable, but in an unexpected yet instructive way they demonstrate the underlying strengths of the U.S. economy.

The collapse of Enron, WorldCom, Global Crossing, and other companies had a chilling effect on investments in equities and venture capital—and for a while engulfed the whole U.S. financial sector. Investors quickly avoided guilty companies and sometimes also innocent companies that happened to be in the same line of business. Arthur Andersen LLP, one of the world's largest and most respected auditing companies, has ceased to exist because of the transgressions of a few employees. Most of the executives responsible for the misdeeds had much of their wealth destroyed by sharp declines in shares of the bankrupt companies they so egregiously mismanaged. Criminal charges take longer to work their way to trial, but leaders of Enron Corp. and other companies may eventually serve prison sentences.

Laws already on the books, along with the financial markets' responses, seem to have been adequate to punish corporate fraud and misrepresentation. Many companies have reviewed and tightened when necessary their auditing and oversight procedures because they witnessed how the market pounded the stocks and hurt the borrowing of transgressors.

With hindsight, investors have concluded that corrupt companies are a small fraction of the approximately 16,000 publicly owned companies in the U.S. The vast majority have abided by accepted rules of corporate governance and of accounting, even though some accounting rules are quite arbitrary.

Placed in this context, the Sarbanes-Oxley Act on corporate governance and accounting appears to have been hastily passed by Congress and too enthusiastically greeted by President George W. Bush. This law requires audit committees to be entirely composed of outside directors and chief executives to certify personally that a company's financial reports accurately reflect its financial condition. It also establishes a Public Oversight Accounting board with vast but vague powers. Since Enron satisfied many of the requirements of this law, Sarbanes-Oxley

probably would not have prevented the debacle at the company.

Moreover, an overly aggressive oversight board and the threat of criminal prosecution of CEOs are likely to make U.S. business leaders less flexible and more cautious. As a result, the law could have a chilling effect on risk-taking by CEOs and entrepreneurs—and that would weaken the business foundations that have propelled the U.S. economy so far ahead of Europe's.

A marker of the economy's strength is its impressive performance in the face of so many traumas: the corporate scandals, the sharp decline in the stock market when the tech and telecom bubbles burst, and the terrorist attacks on September 11, 2001. The recession officially began, according to the National Bureau of Economic Research, in March, 2001, months before the World Trade Center attacks and the blowup of Enron, WorldCom, Tyco, and other companies.

Yet the downturn has continued to be mild, with two quarters of actual declines in aggregate output. Indeed, real gross domestic product grew by over 4% during the recently completed third quarter, up from a little over 1% during the second quarter. Other aspects of the economy are sluggish—unemployment recently hit 6% and may go higher—but not long ago, an economy was considered to be at full employment when jobless rates were 6%.

The downturn has been tame largely because of rapid productivity growth since 1995. When productivity usually falls in downturns because of excess capacity, it has continued to expand at an excellent pace, including during the past quarter. Since productivity is measured by the growth of output relative to the growth in labor and the real capital stock, this impressive performance isn't the result of slick accounting, the Internet bubble, or the general overvaluation of stocks.

Europe has not had as many accounting scandals or as much devastating terrorism, yet the economies have suffered more during this period. The U.S. economy has responded better mainly because fewer regulations and lower taxes make it more flexible and productive than Europe's.

The U.S. economy has shown its mettle with surprisingly good performance in 2002, despite major shocks that would have brought most other economies to their knees. I am optimistic about the future, yet I am concerned that the new legislation on corporate governance and accounting will not help, and may seriously hinder the efficiency and world leadership of the U.S. business sector.

Gary S. Becker, the 1992 Nobel laureate, teaches at the University of Chicago and is a Fellow of the Hoover Institution.

MISSOURI

Blueprint for Prosperity

Missouri's strategy for progress is both simple and bold: Invest in tomorrow.

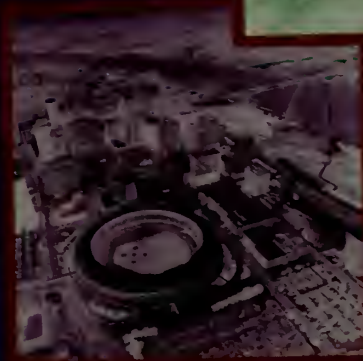
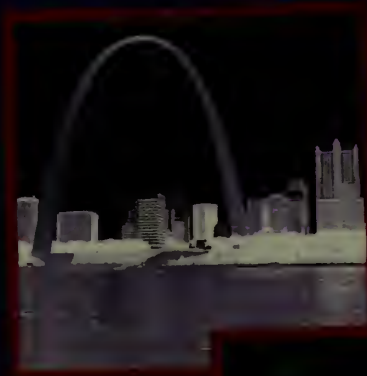
In late November, while almost everyone in Missouri was planning for Thanksgiving, Joe Driskill was wrapping up plans of quite a different kind. After months of preparation, Driskill, director of the Missouri Department of Economic Development, was putting the finishing touches on a new economic agenda for the "Show-Me" state.

The four-point plan was scheduled to be presented to Governor Bob Holden and the state legislature in early December.

Driskill refers to the plan as a blueprint for economic prosperity. He acknowledges that none of its four points — targeting tech-based growth, linking Missouri globally, upgrading the workforce, and growing small business — is an "earthshaking concept." Yet, in the aggregate, they say a great deal about Missouri's determination to shape tomorrow's economy today.

Coming as it does during soft economic times, the "blueprint" makes one thing perfectly clear: Missouri is not about to put its economic future on hold, even though states across the country are struggling with a sluggish economy and budget shortfalls.

Missouri hasn't gone unscathed. By Driskill's account, the state lost 39,000 manufacturing jobs this past year. It's his intention that they will have to be replaced by jobs in the high-tech areas of plant and life sciences, advanced manufacturing and information technology. Still, even in this lackluster period there are healthy vital signs. In southwest Missouri, ➤





From left: Standing 630 feet high, the Gateway Arch in St. Louis commemorates the nation's westward expansion; fountains are commonplace in Kansas City, which is said to have more of them than any city in the world except Rome; Jefferson City, the capital of Missouri, is named in honor of U.S. President Thomas Jefferson.

Throughout Missouri there are state and regional efforts to stoke economic engines, and many herald better days ahead.

Branson, a top tourist destination, hosts 7 million visitors annually. In the east, Lambert-St. Louis International Airport is undergoing a transformation thanks to a \$1.1 billion expansion. To the west, the Kansas City International Airport is benefiting from a \$258 million renovation.

In fact, Missouri has many inherent strengths, not the least of which is its diversified economy. "To our advantage, Missouri has the sixth most diversified economy in the nation," says Governor Holden. "That makes it easier for us to ensure that job opportunities of all kinds are available for our people. But as a state, we are not satisfied anymore with just any kind of job. We desire to create high-wage jobs that will boost the incomes of Missourians."

Throughout Missouri there are state and regional efforts to stoke economic engines, and many herald better days ahead. A prime example occurred in September when good news came out of Jefferson City, the state capital. Governor Holden, faced with budget deficits, nevertheless released \$1.7 million in funds to the University of Missouri-Kansas City from the capital improvements budget. The money is to pay for the planning of a new \$30 million life sciences incubator and educational facility. Meanwhile, earlier funding helped get a new \$60 million life sciences building under way at the University of Missouri-Columbia.

The tandem of university science facilities is a small part of a much bigger picture, according to Dr. Thomas R. Sharpe, executive director of the office of technology and special projects, technology transfer and commercialization for all four University of Missouri campuses. "There's a lot of effort within Missouri to build solid life sciences research, development and commercialization enterprises," says Dr. Sharpe. And, while the campus centers will be key components in making that happen, he adds, "they won't be the only components, because no one can do it alone."

Indeed, there is an emerging Kansas City-Columbia-St. Louis plant-and-life-sciences corridor, with Columbia serving as the central link between the two bigger cities.

HITTING FOR AVERAGE

"We've not hit a grand slam this year, but lots of singles, doubles and triples," says Robert J. Marcusse, president and CEO of the Kansas City Area Development Council, speaking of job growth in the 16-county metropolitan area. As a result, says Marcusse, job growth is off for 2002, but added payroll is at \$60 million, setting a record.

Included among the economic base hits on the Missouri side of Kansas City is the opening of an operations

center in Kansas City by Los Angeles-based IndyMac Bank. Yet another newcomer is Orgo-Thermit, Inc., the U.S. subsidiary of German-based Elektro-Thermit GmbH, which is moving its North American headquarters from New Jersey to the Kansas City area. An additional relocation is that of McKesson Medical-Surgical, Inc., which has signed a long-term lease for a facility in Kansas City. These last two additions play right into Kansas City's plans to build on its substantial life sciences base.

Marcusse says the catalyst for Kansas City's life sciences was The Stowers Institute for Medical Research, established in 1994 by American Century Cos. Inc. founder Jim Stowers and his wife, Virginia, and funded by them to the tune of \$1 billion. The Institute has since made run at recruiting top tier biomedical talent, and has successfully attracted

scientists and researchers from far away as England and France.

One of the outgrowths of the Stowers Institute presence in Kansas City, says Mar-



Missouri Governor Bob Holden

cusse, was the formation of the Kansas City Area Life Sciences Institute Inc., which serves as the coordinating body for the Kansas City region's life science research initiatives. There are

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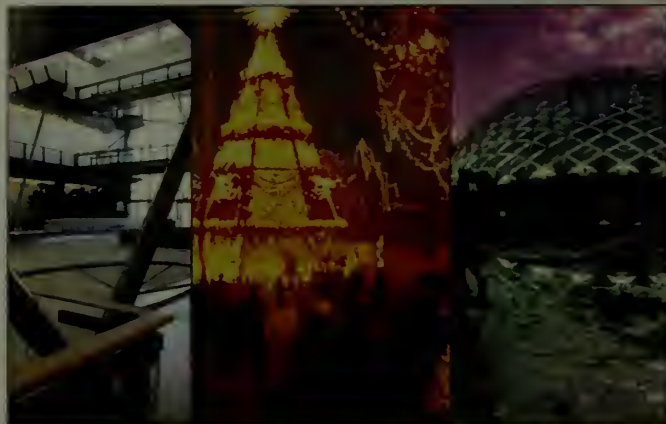
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DEPARTMENT OF ECONOMIC DEVELOPMENT

eight stakeholder institutions, including the Stowers Institute. Within the next five to 10 years, KCALSI hopes to generate \$500 million in annual research investment in Kansas City.

THE ART OF REINVENTION

Conceding nothing to tough economic times, St. Louis has made a priority of competing vigorously to keep and attract business. A little more than a year ago it put one such effort in the win column when MasterCard International opened its new Global Technology & Operations headquarters in O'Fallon, a suburb of St. Louis.

The new building is the nerve center for MasterCard's transaction processing. MasterCard processes as many as 26 million authorizations in this facility on a single day, and settles as much as \$4 billion on a single day between



From left: The \$75 million Donald Danforth Plant Science Center is at the heart of the "BioBel" in St. Louis; Branson, in southwest Missouri, lights up during the holiday seas for visitors; the Missouri Botanical Garden, a major cultural and research institution in St. Louis.

financial institutions worldwide.

The 550,000-square-foot complex, says Jerry McElhatton, senior executive vice president of MasterCard, meets the needs of the company and the community. "For MasterCard, we have a new building with the most sophisticated data center in the industry, a new processing platform that is the most technologically advanced in the industry, and a specially designed environment that combines a physical

facility characterized by unique work spaces designed for efficiency, light and comfort. For St. Louis, we're keeping \$170 million payroll in the area, and more than 2,200 jobs."

When it comes to economic development, St. Louis is nothing if not proactive. "The focus," says Richard C.D. Fleming, president and CEO of the St. Louis Regional Chamber and Growth Association, "is on how we are reinventing ourselves."

Heartland Collaboration:

The Greater Kansas City area, encompassing 17 counties and nearly 2 million people, is a fast rising star in the life sciences arena. With over \$1 billion in public and private life sciences construction currently under way, research funding levels that doubled in the past two years, and eight major research institutions working on more than a dozen collaborative research programs, now is the time to invest in Kansas City's life sciences industry.

In Kansas City, small, medium and large companies will find one of the nation's lowest costs of doing business and qualified assistance from local funding sources such as Gold Bank, one of the nation's premier community banking and financial services companies.

For more information on Kansas City's life sciences industry, please visit the Kansas City Area Life Sciences Institute, Inc. at www.kclifesciences.org. For relocation assistance, please contact the Kansas City Area Development Council at www.smartkc.com or 1-800-SMARTKC.

Promising a Healthy Future for Kansas City



KANSAS CITY AREA
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the University of Health Sciences

Opening in 2003, The University of Health Sciences' Life Sciences Research and Education Center.



Within the past two years, reinvestment has revolved around the rebranding of St. Louis as the BioBelt, a world-class center for plant and life sciences. The key to its success is a cluster of more than 390 firms and 22,000 employees that are at the core of the region's plant and life sciences industry.

Since the launch of the re-branding campaign two years ago, \$2.3 million has been spent on marketing. But the effort is still a work-in-progress. "We're in a marathon, not a sprint," says Fleming.

Even in the short run there is evidence of progress. Despite a slowing economy, the BioBelt in 2001 saw the advent of four venture-capital funds, with \$282 million raised for investment in biotech and life science companies. Meanwhile, two more funds are expected to bring another \$250 million into play.

Another recent development was the opening last fall of the \$75 million, not-for-profit Donald Danforth Plant Science Center. Led by founding president Dr. Roger N. Beachy, the Danforth Center is home to a world-class team

of researchers that ultimately will include more than 200 scientists.

Cooperative efforts are under way among the Danforth Center and other research and educational institutions. These include Washington University in St. Louis, whose medical school ranked fourth in dollars received from the National Institutes of Health in 2001, as well as the University of Missouri-St. Louis, one of the three leading university centers in the U.S. for tropical ecology.

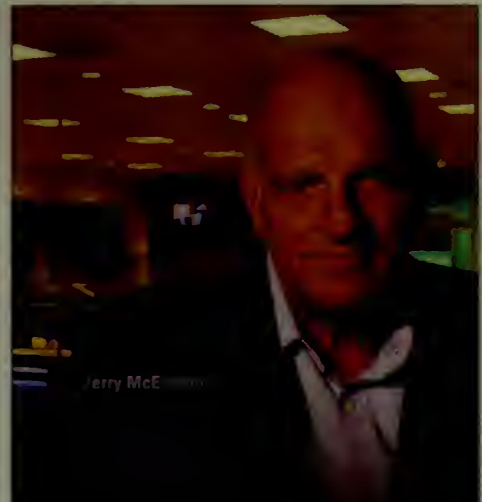
To nurture ventures in plant and life sciences, two business incubators have taken up the challenge. The Nidus Center for Scientific Enterprise houses 15-20 firms, and is dedicated exclusively to the development and growth of plant and life sciences companies. The facility boasts 24 laboratories with wet/dry capabilities and 22 private offices. The Center for Emerging Technologies, which houses a number of life science and medical sector companies, has undergone an \$8 million expansion, doubling in size.

Not to be overlooked is the 79-acre Missouri Botanical Garden, which operates a leading edge research program in tropical botany. Its prestige and importance led California-based Sequoia Sciences to announce its intention of relocating to the Missouri Botanical Garden. And just recently the Botanical Society of America, formerly based in Ohio, moved to the Botanical Garden campus.

From St. Louis to Kansas City, the stage is set for the implementation of the state's blueprint for prosperity. If it works as planned, Missouri will be showing what needs to be done today to get ahead tomorrow. ■

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MasterCard A Commitment to Missouri

MasterCard International, which is an integral part of the Missouri landscape, re-affirmed its commitment to the "Show-Me State" in 2001 when it moved into a \$130-million, 52-acre campus outside St. Louis. The facility, which is MasterCard's largest office in the world, is home to some 2,200 IT professionals.

The St. Louis facility houses the industry's most advanced payments platform, handling processing for nearly all MasterCard transactions worldwide. The platform uses a virtual private network – Banknet – to link 210 countries, 25,000 customer financial institutions, and 29 million merchants worldwide. Banknet enables MasterCard to authorize transactions at unparalleled speeds and easily processes tens of millions of authorizations a day.

"We're extremely proud to call Missouri the home of MasterCard's Global Technology and Operations headquarters," said Jerry McElhatton, MasterCard International's senior executive vice president, Global Technology and Operations. "Our commitment to Missouri remains strong, and we look forward to continuing this relationship for years to come."

For more information on MasterCard, visit <http://www.mastercardinternational.com>.

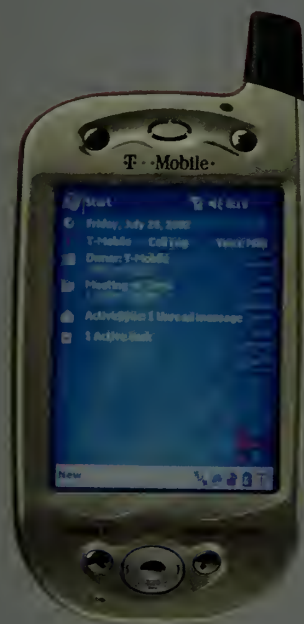
MasterCard
International



From top: The \$200 million Stowers Institute for Medical Research in Kansas City; a researcher at Orion Genomics, which is located at the Center for Emerging Technologies in St. Louis; the new \$60 million Life Sciences Center under way at University of Missouri-Columbia.



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call and access
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gratification
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JAMES C. COOPER & KATHLEEN MADIGAN

THE RECOVERY GAINS TRACTION AFTER A MUDDY AUTUMN

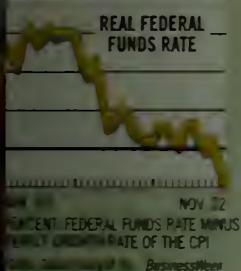
Look for stimulative policy, firmer pricing, and solid productivity in 2003

U.S. ECONOMY

As economic seers turn their attention to 2003, keep in mind an old saying among forecasters: The consensus is always wrong. That's especially true around turning points in the business cycle. The real trick is to decide which way the muddle in the middle will err: Will the consensus be too optimistic or too pessimistic?

In the coming year, the economy will most likely overshoot the consensus forecast of 3.2% growth (page 38). The Iraq factor will be an early hurdle, but the economy heads into the new year with a solid base supported by the three P's: policy, prices, and productivity.

VERY ACCOMMODATIVE FEDERAL RESERVE



First, the combination of monetary and fiscal policy is already as stimulative as it has been at any time since World War II (charts). On the fiscal side, the policy boost can be seen in the swing in the federal budget, which captures how changes in taxes and spending affects the economy. In fiscal 2002, which ended Sept. 30, the budget took a

sharp swing, from a surplus of \$127.3 billion in 2001 to a deficit of \$159 billion, an economic thrust of some \$286 billion, or 2.8% of gross domestic product. The deficit is expected to widen further in 2003, to perhaps \$225 billion. But the fiscal boost could be even greater than that, since the Bush Administration and the new Republican Congress are sure to push through another sizable stimulus package (page 40). Some, but not all, of the federal lift will be offset by higher taxes and less spending on the state level. State budgets are expected to be in the red by some \$60 billion for the coming fiscal year, and unlike Washington, most states must balance their budgets by law.

MONETARY POLICY

has not been stingy, either. In fact, you have to go back more than two decades to find a period when the Federal Reserve was as stimulative as it is now. That's clear from the current level of the Fed's policy target, the overnight federal funds rate, adjusted for inflation. Based on the latest consumer price index—which showed yearly inflation at 2.2% in November—and a fed funds rate of 1.25%, the real policy rate is -0.9%, compared with a long-run average of about 2%. That's the widest gap and the

most negative real rate since the 1980 recession.

Equally important to the outlook is the fact that the Fed will be willing—and able—to keep policy exceptionally accommodative toward economic growth. For the first time since the early 1960s, the Fed has achieved its long-run goal of price stability. Practically defined, that means inflation is so low that it is not a factor in business decisions or buying behavior.

At price stability, the Fed must treat both inflation and deflation with equal respect, so monetary policy in 2003 will not be a one-sided effort geared toward cutting inflation, as has been the case for most of the past 40 years. The beneficiary of this new policy imperative will be the recovery, because the Fed has unprecedented leeway to err on the side of stimulus.

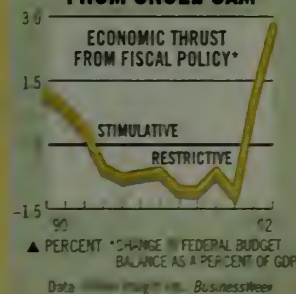
THAT DOESN'T MEAN

deflation will be a worry in 2003. On the contrary, with stimulative policy helping to boost demand, the economy's second P, prices, are showing signs of firming up. In particular, commodity prices are rising. The Commodity Research Bureau's spot price index of industrial commodities, which does not include energy items, is 10.8% higher than it was a year ago and at its highest level in almost two years. Rising commodity prices are not an inflation indicator but a sign of healthier demand.

Stronger prices are showing up in the early stages of the production process. In the year ended November, 2001, core prices for crude goods fell 9.6%, but now they are up 11.6% from a year ago, reflecting the gain in commodity prices. For intermediate supplies that go into finished goods, such as fabrics and electronic components, trends have also shifted. A year ago, these prices fell 1.4%; now they are up 1.4%.

Domestic-goods prices are also starting to get a lift from the declining dollar, which makes imported goods more expensive and provides some cover for U.S. producers to charge more. Since February, the trade-weighted dollar has declined about 10%. The drop has accelerated in recent days, as investors and traders began to question Treasury Secretary nominee John W. Snow's commitment to a strong dollar. Thanks in part

EXTRA STIMULUS FROM UNCLE SAM



Business Outlook

to the dollar's slip since February, prices of nonoil imported goods have risen 0.8%, after declining sharply during the previous year.

Another key reason for optimism is the third and perhaps most important P: productivity. The best yearly productivity performance in two decades is supplying its own boost to demand by lifting the profitability of businesses and the real wages of workers.

In fact, the recovery is looking more and more like the expansion of the early 1960s—a period of high productivity, characterized by low inflation and interest rates, and rising profitability and real wages. The most important point to take from the '60s is that companies made money even when pricing power was hard to come by. Using that precedent as a guide, Corporate America could post some positive profits surprises in 2003. That's especially likely if demand proves to be stronger than now expected.

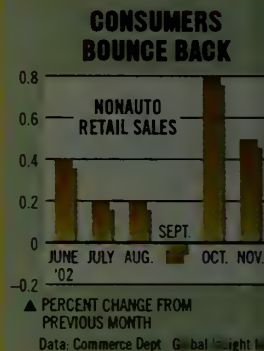
IN FACT, THE LATEST DATA strongly support the notion that the economy is emerging from its autumn soft spot. In particular, both retail sales and industrial production in November bested expectations, indicating that consumers are brightening the holidays for retailers and that manufacturers are stirring back to life.

Everyone expected the end of zero-rate car financing to crimp the overall data for retail sales in October and November, and it did. But the real story is that, ex-

cluding autos, retail sales jumped 0.8% in October and 0.5% in November (chart). The combination of strong demand and cautious ordering has left some retailers short of inventories. So far this year, sales at manufacturers, wholesalers, and retailers have risen more than three times faster than their stockpiles.

Lean business inventories suggest some improvement is on the way for manufacturers. In November, industrial output rose a slim 0.1%, but it was the first increase since July, led by a rebound in auto output. Production of business equipment continued to decline in November, but the losses are narrowing, and output at high-tech industries posted a 0.6% advance for the second month in a row.

While manufacturing has a long way to go before it recovers completely, the economy's quick skip over the soft patch indicates how prices, policy, and productivity have kept demand healthy despite the summer's stock market decline, geopolitical risks, and the overall paralysis of the business sector. In 2003, look for the economy to continue benefiting from this trio of P's. And don't be surprised if many forecasters become a little more optimistic as the year progresses.



EASTERN EUROPE

THE BIG EU HOPEFULS ARE PUSHING THEIR LUCK

The European Union espouses fiscal discipline and practices cautious monetary policy. However, the four largest aspiring EU entrants—Poland, the Czech Republic, Hungary, and Slovakia—aren't exactly following the EU example, which may lead to problems later on.

On Dec. 16, the National Bank of Hungary lowered its benchmark interest rate to 8.5%, for a total cut of 1.25 percentage points in 2002. The Czech central bank cut rates from 4.5% to 2.75%, and Slovakia slid from 7.75% to 6.5%. But the National Bank of Poland has been the most aggressive. It has cut rates to 6.75%, from 11.5%, in an effort to boost Poland's eco-

nomics growth, expected to be just over 1% in 2002.

The central banks are hoping to lift economic growth in two ways: by stimulating consumer demand and limiting the rise of their currencies. The strong currencies, a result of high real interest rates, have been a drag on exports.

The moves should pave the way for Eastern Europe to outpace the euro zone in 2003. For example, Polish real gross domestic product is forecast to grow by at least 2.4%. For the other three nations, economic growth of 2.8% to 3.5% is expected, twice the likely pace of the euro zone. Moreover, if growth begins to disappoint, there

is plenty of ammo left. Real interest rates currently range from 2.25% to nearly 6%, much greater than the euro zone's 0.7%.

Stimulus is also coming from the government. All four countries are running budget deficits of greater than 5% of GDP in 2002 and are expected to carry budget deficits of 4.5% or more in 2003.

Such profligacy could cause problems in 2004, when entry into the EU will begin. The four countries will eventually lose the ability to control interest rates and run large fiscal deficits, especially since the EU wants its new members to carry deficits of only 3% of GDP by 2006. This could put the EU hopefuls in a bind: Either risk delaying integration or suffer major drags on economic growth from large fiscal spending cuts.

By James Mehring in New York

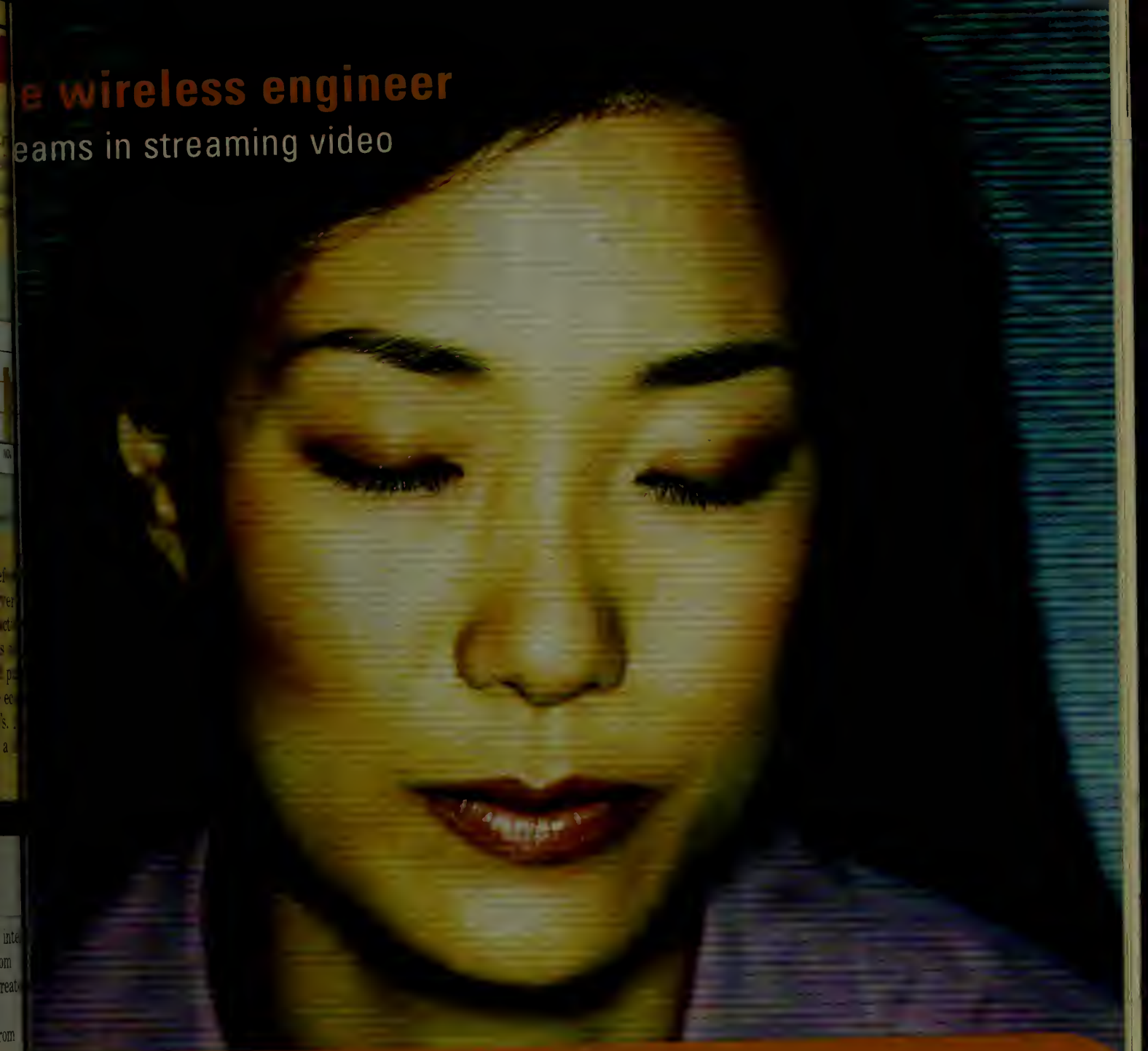
STEADY GROWTH, FOR NOW

FORECASTS FOR REAL GDP GROWTH
PERCENT CHANGE
2002 2003

CZECH REPUBLIC	2.2	2.8
HUNGARY	3.3	3.3
POLAND	1.2	2.4
SLOVAK REPUBLIC	4.0	3.5

Data: J.P. Morgan Chase & Co.

the wireless engineer
dreams in streaming video



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THE GREAT BUDGET DEBATE

Supply siders and deficit hawks will square off over the best way to rev up the recovery

When Congress returns in January, President George W. Bush is almost certain to propose an economic-stimulus package that includes a heavy dose of tax cuts. Yet already, even without the Bush plan, the nation's budget deficit is expected to soar past \$200 billion in current fiscal year 2003.

That collision of big tax cuts and ballooning deficits has set the stage for an acrimonious debate over how large a tax cut the U.S. can afford and whether the positive effects of lower taxes can outweigh the negatives of deeper deficits. Along with the prospect of war with Iraq, tax cuts vs. deficits will be one of the defining political and economic issues of 2003.

Predictably, the fight is breaking down along party lines. Most Republicans, even if they abhor big deficits, will eventually line up behind the Bush plan. Likewise,

tax cuts will be attacked by Democrats on the grounds that they create bigger deficits.

Lost in the political dogfight, however, is the critical economic question: What provides a bigger boost for the economy, tax cuts or deficit reduction? The debate has raged among economists since at least 1980, when then-Presidential candidate Ronald Reagan proposed big tax cuts. Supply siders contend that cutting tax rates can unlock forces of long-term growth powerful enough to compensate for bigger deficits. Deficit hawks hold that big federal budget gaps drain vigor from the economy, even with lower tax rates.

Over the past 20 years, economists have learned a lot about the relative impact of tax cuts and budget deficits. But the real advances in knowledge have been obscured by the tendency of partisans on both sides—including economists who should know better—to make exaggerated claims.

The bottom line: At today's levels, income taxes aren't a big burden on long-term economic growth. Similarly, while the budget gap may seem large in absolute terms, it's far below the share of gross domestic product that has historically triggered problems. Once the overheated rhetoric is cleared away, Washington has the flexibility to shape a

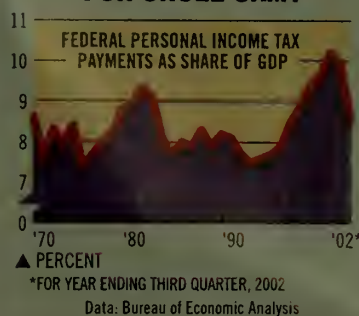
fiscal-stimulus bill that addresses the needs of the sluggish economy. Here's primer on the issues that will help sort through the truths, half-truths, and exaggerations in the coming debate.

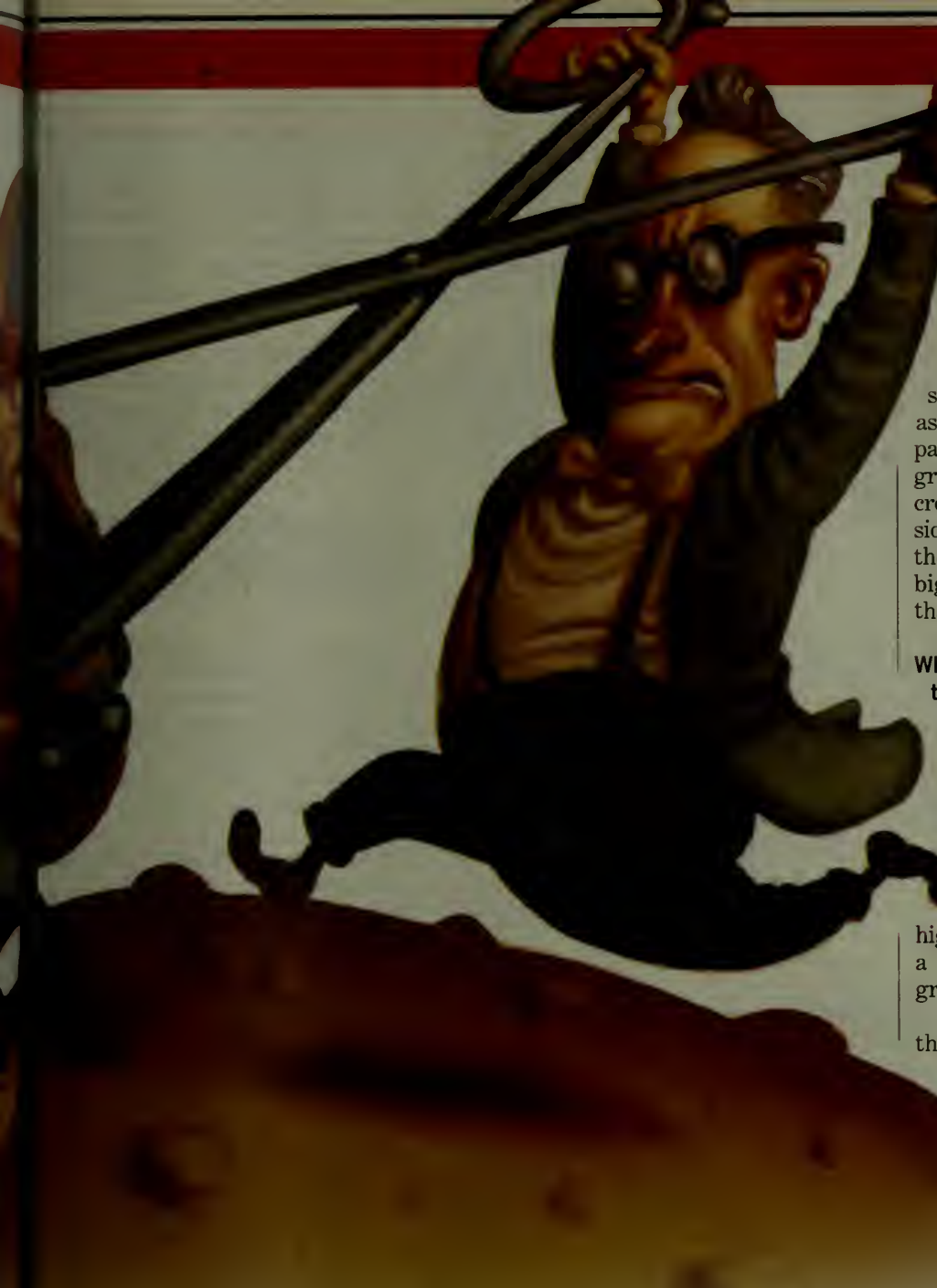
Let's start with the basics: Have federal income taxes been going up or down over the long term?

Surprisingly, the long-term trend the income tax has been more or less flat. Over the past 30 years, federal income tax has generally absorbed 8% to 9% of GDP. When it goes much above 9%, as it did in 1981 and 2000, it creates political pressure for tax cuts. When it drops below 8%, as it did in the early 1990s, that opens the door for tax hikes.

Over the past year, with part

A SMALLER SHARE FOR UNCLE SAM?





sort of tax cuts being proposed by Bush "will not have an effect on aggregate economic activity," says Joel B. Slemrod, a tax economist at the University of Michigan.

Moreover, a moderate tax increase appears not to hurt the economy, despite what supply siders claim. In 1993, as President Bill Clinton's tax hike was passed, then-Representative Newt Gingrich (R-Ga.) declared that "the tax increase will kill jobs and lead to a recession." Yet what eventually followed was the longest expansion in U.S. history, a big surplus, and an unemployment rate that fell below 4%.

What about the other effects of lower taxes?

Supply siders make a plausible case that lower tax rates can encourage people to get more education, since they'll retain more of the eventual benefits. And highly skilled workers are more likely to start or join risky new businesses if they expect to keep more of their higher wages. One study, suggests that a lower marginal tax rate boosts the growth rate for small businesses.

But the time lags are much longer than supply siders admit. It may take years—or decades—for lower taxes to have a payoff in a better-educated workforce and new-business formation.

h's 2001 tax legislation already in effect, federal income taxes have fallen 8.6% of GDP, right around the 30-year average of 8.4%.

Income taxes are not overly oppressive. So, what are the economic arguments for further cuts in tax rates?

In the short term, tax cuts clearly pick up the economy by putting more money in consumers' pockets. It does so, however, which taxes are cut. Lowering taxes paid by high-income filers is likely to hike savings, which could give an upward jolt to the stock market. In contrast, a cut in the Social Security payroll tax paid by employees would mostly benefit low-income workers, who

are more likely to spend it quickly.

The more difficult question, though, is the impact of tax cuts on long-term growth. The core of supply-side theory is that people are discouraged from working harder, investing in themselves, and taking risks if they have to give much of their additional income to the government in the form of taxes.

But after countless economic studies, it's clear that those arguments have been overstated. The positive incentive of lower tax rates on the labor supply is limited. Research shows that it applies mainly to married women, who face high marginal tax rates on their income. Yet this group makes up only 30% of the adult population. As a result, the

So it's hard to make a strong case in favor of tax cuts. Are there better arguments for holding down budget deficits as a way of boosting growth?

There's just as little hard economic evidence supporting the views of deficit hawks, despite the inherent logic of their argument. Deficit hawks believe that a big budget gap means the government has to borrow more, which drives up interest rates and hampers investment. The theory is that the more the government dips into the nation's savings, the less is available for the private sector. That was the argument made in the early 1990s by Robert E. Rubin, Clinton's top economic adviser who became Treasury Secretary in '95.

Based on this reasoning, various macro-econometric models have esti-

mated that budget deficits will have a big impact on interest rates. On average, these models report that a tax cut that swells the deficit by 1% of GDP will boost long-term interest rates by 60 basis points, reports a new paper by Brookings Institution economists William G. Gale and Peter R. Orszag.

That seems like a pretty straightforward indictment of deficits. So why the continued debate?

The real world doesn't work the way the models predict. In the 1980s, despite giant budget deficits, real interest rates—interest rates minus inflation—fell rather than rose. The real rate on 10-year Treasury bonds stood at 8.7% in 1984, when the budget gap was roughly 5% of GDP. But by 1986, the real rate had fallen to 4.5% because the U.S. attracted enough foreign money to make up for big budget deficits.

The real world didn't behave as expected in the 1990s, either. Even as the budget shifted from a deficit of \$290 billion in fiscal 1992 to a surplus of \$236 billion in fiscal 2000, real interest rates dropped only slightly, from 4.2% to 4.1%. Nevertheless, investment and productiv-

ity growth soared far beyond the hopes of even the most optimistic forecasters.

The deficit-hawk argument failed globally in the 1990s as well. Both Japan and Germany devoted far more of their output to national savings than the U.S. did. So, according to anti-

WHO'S RIGHT? SO FAR, NO ONE

WHAT REAGAN'S CRITICS SAID ABOUT HIS TAX CUTS AND THE RESULTING DEFICITS

WHAT REALLY HAPPENED

deficit reasoning, their higher national savings should have driven down interest rates and spurred investment. Japan, especially, had a national savings rate well in excess of 30% in the first half of the 1990s—about double that of the U.S. Yet the U.S. economy performed much better.

How could that be?

As global capital markets become in-

creasingly integrated, national economies become less limited by the funds they generate internally. Thus, the U.S. was able to fund 20% of the late 1990s investment boom with foreign capital.

And with capital easily available, what distinguishes an economic

“The durability of this economic expansion is going to be significantly limited by the huge deficits in the federal budget.”

Henry Kaufman, then-chief economist at Salomon Brothers

An expansion of almost eight years in late 1982, marked by a 4.3% annual growth and a 160% rise in the stock

market, transformed the U.S. from a strong country from a weak one is not because competitive its markets are and it well it fosters innovation. Japan, without much competition or encouragement for innovation, wasted that pool of national savings on low-productivity projects.

Does that mean there are no links between deficits and interest rates?

No. Brookings' Gale and Orszag

WHY THE SUPPLY SIDERS ARE SCRAMBLING

Supply-side advocates are steaming mad. Stung by the appointment of two economic traditionalists to top spots in the Bush Administration, such conservatives are launching an offensive to get their voices heard inside the Oval Office. To counter the naming of John W. Snow as Treasury Secretary and Stephen Friedman as National Economic Council director—both of whom are considered deficit hawks—they are pushing their own candidates for lower-level positions. They're not only lobbying the Administration for bigger tax cuts, they also want cuts shaped more to their liking. And they're pressing Congress to adopt a controversial new budget forecasting method, known as dynamic scoring, that will make those tax reductions easier to pass (see box).

Leading the charge are Stephen Moore, head of the Club for Growth, which finances cam-

paigns for supply-side-oriented candidates, and Grover G. Norquist, president of the stridently antitax Americans for Tax Reform. Moore has publicly chastised the Administration for its choice of Friedman as NEC head. His group has frequently annoyed the party's Establishment by opposing moderate Republicans in primaries. Norquist, more of an insider, helps coordinate the lobbying efforts of conservative groups, bringing them together for frequent meetings. He also talks regularly to Karl Rove, Bush's powerful political adviser. And he worked behind the

THE CONSERVATIVE WISH LIST

► Key posts in the Administration and Congress, including the No. 2 slots at the NEC and Treasury

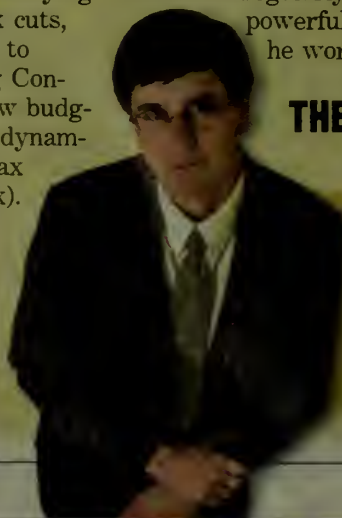
scenes with the White House to the mini-revolt against Friedman.

These and other tax-cut advocates are pushing an assortment of candidates for posts in the Administration and Capitol Hill. Among the names mentioned: David Malpass, chief economist for broker Bear, Stearns & Co.; Alan Reynolds, senior fellow at Cato Institute libertarian think tank; and J.D. Foster, who's already in the Administration at the Office of Management and Budget.

Within the Administration, supply-siders have set their sights on the Deputy Treasury position under



They're hoping spots will open in Treasury and the White House. “It would be great to have the President surrounded by many supply-side cutters as possible,” Moore says. T



ON THE MARCH: Moore (left) and Norquist are leading the fight for supply-sider postings

► Federal budget estimates to be done using “dynamic scoring,” which would take into account the potential economic impact of tax cuts

► Cutting—or eliminating—the 20% capital-gains tax

that interest rates are sensitive to projected budget deficits rather than current deficit. Econometric studies seem to support the view that a tax change that boosts projected deficits also raise interest rates. Unfortunately, over the past 20 years, short-term projections of the budget gap have turned out to be consistently wrong. Long-term deficit forecasts de-

ately. First is the question of what the U.S. economy can afford as the country grapples with supporting retired Americans. That's a function of future growth.

An economy that grows at 4% a year over the next 30 years will be 33% bigger than one that grows at 3% a year. That's an \$8 trillion difference in today's dollars and enough to support

In other words, the U.S. government can run as big a budget deficit as it wants without any consequences?

No. Just as there's a limit to the tax burden Americans are willing to pay, there also appears to be a limit to how big the deficit can get relative to the size of the economy. Historically, when the federal budget gap has approached 5%, as it did in 1983, 1986, and 1992, politicians have felt pressure to do something about it.

We're not approaching that limit yet. The Congressional Budget Office projected that the budget gap would be less than 2% of GDP in fiscal year 2003. Adding the potential costs of an Iraq war would bring the deficit up to 3% of GDP or so. That means there's room to give the economy a fiscal jolt. Either a tax cut of \$100 billion a year—1% of GDP—or spending increase of similar size would help boost growth without pushing budget deficits dangerously high.

Ultimately, the U.S. economy is remarkably flexible and resilient. As long as tax cuts and budget deficits don't get too far out of line, American businesses will keep growing and innovating. That's the crucial point to keep in mind as the supply siders and deficit hawks get ready for battle.

By Michael J. Mandel in New York

ANTON'S
SAID
HIS TAX
1993

“The tax increase will kill jobs and lead to a recession...and actually increase the deficit”

Newt Gingrich, then-Representative (R-Ga.) and future Speaker of the House, 1993

EALLY
ED

The longest expansion in U.S. history, a 2.5% annual rise in productivity in the second half of the '90s, a big budget surplus, and a jobless rate that fell to 3.9%

on notoriously unreliable projections of growth and productivity. Thus, the claim that interest rates are sensitive to projected budget deficits doesn't fool you much.

What about Social Security? Don't we need to run a budget surplus to fund retirement of baby boomers?

It's not that simple. The two are issues that need to be considered sepa-

retirees if properly distributed.

The other issue is how to fix the funding mechanism for Social Security. Because of the way the system is currently designed, Social Security's financial situation will not improve much even if the country posts faster economic growth. Thus, the Social Security system will have to be changed to ensure its long-term financial viability.

case, for its part, has signaled willingness to appoint more supply-siders. But it's given no hint of who they might be.

The two posts coming open that conservatives prize most are not in the Administration. They're on Capitol Hill: the heads of both the Congressional Budget Office and the Joint Committee on Taxation are about to retire. The two are critically important as they act as budget scorekeepers in Congress, totting up the costs of taxes and spending.

Supply siders have long complained that budget-scoring methods employed by the CBO and JCT. They argue that bean counters have consistently underestimated the potential loss of revenues from tax cuts because they don't take into account the impact that lower taxes can have on economic growth. Instead of the model used now, conservative Congress to adopt dynamic scoring that recognizes that tax cuts can enhance long-term growth.

Lower taxes, of course, are the sine qua non of the supply siders, who see them as a means of encouraging entrepreneurship. High on most supply siders' wish list: reduction or elimination of the capital-gains tax, which they

argue inhibits investment. In fact, some are pushing the Administration to include a capital-gains tax cut in the package to be unveiled in January. So far, though, the Bushies don't seem to be listening. But that's not stopping the

supply siders, who are on the warpath—and likely to stay there until Bush proves his tax-cutting bona fides all over again.

By Rich Miller, with Howard Gleckman and Richard S. Dunham, in Washington

HOW DO YOU TALLY THE BENEFITS OF A TAX CUT?

Even before President Bush unveils his fiscal agenda, policymakers are engaged in a backroom brawl over how to quantify the cost of upcoming tax cuts. The debate has been kicked off by supply siders, who want congressional forecasters to adopt a controversial new method for measuring the impact of tax cuts on the economy and the budget.

Why? Supply siders claim the technique, “dynamic scoring,” calculates the effect of lower taxes on the economy more accurately than traditional forecasting. That's because dynamic scoring takes into account the growth brought about by declining taxes, which, they say, leads to more tax revenues and a lower deficit.

Suppose, for instance, Congress wanted to cut capital-gains rates. Dynamic scoring would figure whether

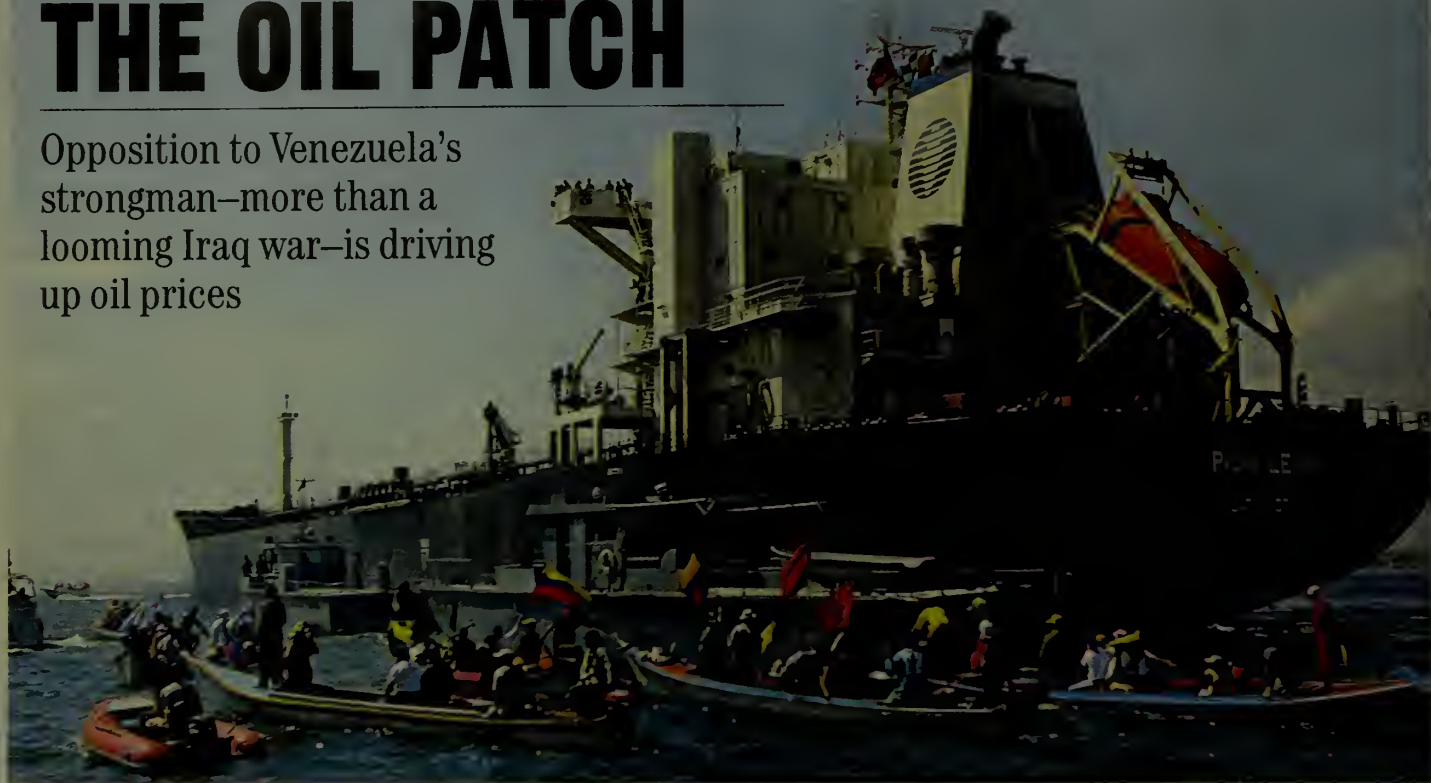
such a cut would prompt investors to sell stock—and measure how much. It would then calculate how such sales would influence overall market values, and how a change in stock prices would affect the economy. Finally, dynamic scoring would figure how those broad changes raised or lowered overall tax revenues and, thus, the budget deficit.

Today, Congress does calculate the impact of capital-gains cuts on behavior. But it does not take the additional steps of sorting out the consequences for the economy. Critics say the reason is simple: The tools to do such calculations do not exist. Moreover, because dynamic scoring relies on arbitrary assumptions, they believe it can be manipulated, for political reasons, to show a lower deficit.

By Howard Gleckman in Washington



Opposition to Venezuela's strongman—more than a looming Iraq war—is driving up oil prices



Venezuela matters because it supplies about nine times as much crude oil to

PROTESTERS

The situation is "deteriorating rapidly," the U.S. State Dept. warns

There's still breathing room for U.S.: The drop-off in Venezuelan exports hasn't lasted long enough yet to make a big dent in U.S. supplies. Dec. 17, the American Petroleum Institute announced that inventories had risen a modest 1.1% in the latest week. Inventories could keep shrinking if Venezuela's wells remain shut, traders are betting that more oil will

Who Can Pump More Oil?

SOURCE	ESTIMATED CAPACITY MILLIONS OF BARRELS PER DAY IN OCTOBER	ESTIMATED SPARE CAPACITY
SAUDI ARABIA	9.5	1.40
IRAQ	2.8	0.30
UNITED ARAB EMIRATES	2.35	0.25
KUWAIT	2.25	0.24
NIGERIA	2.25	0.15
LIBYA	1.45	0.11
IRAN	3.50	0.07
OTHER OPEC PRODUCERS	5.95	0.17
NON-OPEC PRODUCERS	48.6	0.30

Data: Edward L. Morse, Hess Energy Trading Co.

either
seas or from
strategic re-
ve. On the
v York Mer-
ile Exchange
Dec. 18, oil
ed at \$30.44
January de-
ry and \$30.43
February, but
\$29.63 for
ch and \$28.59
April—a
that traders
nk the pres-
e will ease.
for an oil-
e rise to
e a big im-
on the U.S.
nomy, it gen-
ly takes at least a \$10-per-barrel
e increase that's sustained over
y months. While today's prices are
above the low of \$20 per barrel
oil sank to a year ago, they aren't
above the mid-\$20s average of the
few years. The national average
e of gasoline on Dec. 16 was just
er \$1.38, down from the \$1.46 it
hed in late October on fears of an
war, according to Opus Energy
up of Lakewood, N.J.

That's not to say there is nothing to
ry about. There's no guarantee that
big Mideast producers will supply
ugh oil to compensate for the
enezuelan strike if it endures. OPEC
been trying to reduce output. The
states fear that, if the strike ends
uptly after they've increased pro-
tion, there will be an oversupply
t causes prices to crash. "This is re-
a difficult situation," says a gulf oil
cial. "If it's going to create a short-
e, we have to do something.
ht now, we don't think
re's going to be a shortage."
Likewise, President Bush
ht not release oil from the
ategic Petroleum Reserve
ess the situation gets des-
ate. That oil is supposed to

ON GUARD

**A Chavez move
to break the
strike may spur
more violence**

strike drags on for a few more weeks,
oil could hit \$35 or even \$40 a barrel—
although it would have to stay at that
level for several months to damage the
economy.

The oil threat from an Iraqi war
is less immediate but potentially more
severe. Lehman Brothers Inc. global
chief economist John Llewellyn in
London figures there's a 70% chance
that there will be no war or an easy
war with Iraq, causing oil prices to
fall to \$20 a barrel. But he estimates
that there is a 5% chance that the
conflict could spread to other parts of
the gulf, potentially driving oil prices
to \$75 a barrel or more. Impossible? He
regards the \$3 price increase resulting
from Venezuela's troubles as a warning:
"It shows what even a modest supply
disruption can do in a tight market."

The latest spurt in oil prices will
probably recede without harming the
U.S. But who knows? After all, it was
not obvious at the beginning
of December that the oil-ex-
porting strongman who roiled
the markets would be named
Chavez.

*By Peter Coy in New York,
with Stanley Reed in London
and Geri Smith in Mexico City*

be for emergen-
cies, not to
smooth out price
fluctuations. For
now, the Energy
Dept. has al-
lowed oil compa-
nies to suspend
their contribu-
tions to the
Strategic Petro-
leum Reserve,
freeing up more
oil for sale to the
public. But it's
hoping to avoid
allowing the re-
serves to be
tapped. As a
result, Alaron's
Flynn says that
if the Venezuelan

GOVERNANCE

MEMO TO CEOs: GIVE IT UP

**Investors want them to return
gains from hot IPOs**

The shareholder revolt is gaining
steam. Top execs at Disney, Qwest,
eBay, and Ford now face demands
from investors that they return to their
companies profits they pocketed from
hot initial public offerings.

These latest moves spring from
probes begun earlier this year by Con-
gress and New York Attorney General
Eliot Spitzer into the rich IPO grants
investment banks gave to their best
clients in the booming '90s. In Septem-
ber, Spitzer sued five telecom execs to
force them to give back some \$28 mil-
lion they banked from IPOs. The argu-
ment: The money belongs in company

coffers since the execs
got to buy the shares
only because they held
influential jobs with im-
portant banking clients.

Now investors are
using those same argu-
ments to try and win
money back from the
corner office. They say
Disney Chief Executive
Michael D. Eisner,
Ford CEO William Clay

CEO WHITMAN

Ford Jr., and several eBay Inc. execu-
tives, including CEO Margaret C. Whit-
man, received hot stocks from Goldman
Sachs Group Inc. Salomon Smith Bar-
ney, investors say, funneled IPOs to ex-
Qwest Communications CEO Joseph P.
Nacchio for the same reason.

Disney, Ford, and eBay say their ex-
ecs have long had personal relationships
with Goldman and did nothing wrong.
Still, Disney and Ford have asked inde-
pendent board members to investigate.
Qwest says it plans to review the com-
plaint while Nacchio, Goldman, and Sa-
lomon all declined comment.

Investors are vowing to go after CEOs
at other companies. "This practice has
been going on unchecked for too long,"
says shareholder lawyer Robert E. Curry,
a senior partner at Kirby McInerney &
Squire LLP in New York. Legal experts
say the current cases could succeed if in-
vestors can prove that companies would
have bought the IPO shares had they been
given the chance. Win or lose, the in-
vestor backlash from the go-go '90s will
surely carry over into 2003 and beyond.

*By Linda Himelstein in San Mateo,
Calif., with bureau reports*



TELECOM

GO EAST, YOUNG CHIPMAKER

For Qualcomm, India and China are risky growth bets

For wireless highflier Qualcomm Inc., India represents everything right and everything risky in the company's global game plan. On Dec. 28, Indian conglomerate Reliance Group will march into 600 cities, offering cheap calling plans with jazzy features such as wireless games and text messaging. The service uses Qualcomm's patented chip designs and could become Qualcomm's wedge in the world's fastest-growing cellular market. But Reliance already faces a host of difficulties, including legal challenges by competitors and sluggish response from consumers, many of whom are too poor to afford any phone service.



CEO JACOBS

At the moment, these troubles may seem trivial. Qualcomm is at the peak of its powers, having swung from a \$578 million loss in 2001 to a profit of \$360 million in the year ended Sept. 29. Chip shipments for the six-month period ending next March should hit 52 million units—nearly double the volume for the same period a year earlier, largely due to anticipated demand in India and Qualcomm's other big new market, Chi-

na. Investors have taken note, bidding Qualcomm's shares up 46% since July 1, to \$38. In the same period, the Philadelphia semiconductor index fell 19%.

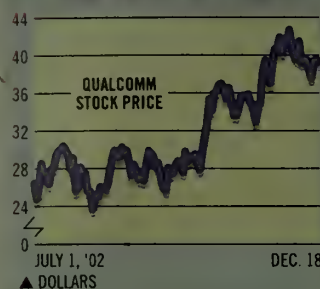
Irwin M. Jacobs, Qualcomm's CEO and chairman, would like to convince Wall Street that India and China are the next two chapters in his triumphant tale. And shareholders long to believe him. Why? Because beyond 2003, many analysts think Qualcomm could face a slowdown in its core markets: the U.S. and South Korea. And in Europe, plans to roll out a new generation of cell phones incorporating Qualcomm technology have hit the skids.

That puts the growth burden on India and China. And though the cell-phone markets in those countries are largely virgin territory, political, economic, and competitive pressures stand in Qualcomm's way. "By pinning its hopes to Asia, Qualcomm is taking on a potentially huge downside risk," says Legg Mason Inc. analyst Craig Mallitz.

Jacobs is optimistic about India—and not without reason. Qualcomm's chips deliver a technology called CDMA, which allows cellular networks to support more simultaneous calls than competing approaches such as Europe's GSM standard. So CDMA networks are cheaper to operate and hence well suited to developing countries, Jacobs contends. India's Reliance, for example, aims to offer plans starting at a rock-bottom \$12.37 a month.

But as Qualcomm has learned, superior technology isn't always the deciding factor. CDMA is

ONE HECK OF A RUN



Data: Bloomberg Financial Markets

losing out to GSM worldwide, with only about 20% of phones sold incorporating the much-mired technology. Not just as Reliance gears for its launch, Indian telecom regulators have been sued by Hutchison Telecom and others, who claim that Reliance has been allowed to expand at an unfair price advantage.

While the lawsuit won't delay Reliance's CDMA launch, it could deter some customers and slow the takeoff.

Qualcomm faces challenges in China, too. China Unicom Ltd., which launched its CDMA service late last year, had to slash the price of the average \$350 phone to meet its goal of recruiting 7 million subscribers by the end of the year. Analysts predict Unicom will eventually subsidize the phones. That could dampen the prospects for Qualcomm, which has already made huge concessions to get its foot in the door in China. For example, the company accepts royalties of just 2% of the manufacturer's selling price for phones made in China, compared to an average of 5% elsewhere.

Jacobs wants China and India to be bastions of CDMA. In July, he opened a 43,000-square-foot research and development center in Beijing. In India, Qualcomm vowed to invest \$200 million in Reliance's CDMA rollout—then held back by the gift when Reliance failed to order CDMA equipment by agreed-upon deadlines. But Qualcomm could change its mind yet again. "It's about showing support for their efforts," he says. Clearly, in both India and China, Qualcomm needs all the support it can get.

By Arlene Weintraub in Los Angeles
with Manjeet Kripalani in Bombay
Bruce Einhorn in Hong Kong

HOLD ON: Political and economic pressures could slow Qualcomm's advance into India



COMMENTARY

By Robert D. Hof

E-TAIL STOCKS: 'TIS THE SEASON TO BE WARY

Throughout the fall, investors have snapped up stocks of e-commerce companies with a fervor reminiscent of the late '90s. buoyed by signs of a green Christmas for e-tailers, shares in eBay, Amazon, and Yahoo are soaring. On Nov. 25, Amazon.com Inc.'s stock hit a two-year high of \$24.25, up 43% since the start of October and a 102% gain for the year. Yahoo! Inc., a growing force in online shopping, has shot up 73% since early October, to about \$17, while eBay Inc. has jumped 30%, to some \$19, in the same period. Are these investors nuts?

Pretty much. And they should know better by now. Last year, e-commerce stocks also rose in anticipation of the seasonal burst of business, only to tumble once the holidays ended. Shares of eBay jumped from around \$44 in late September to \$70 in early December, for example, then fell below \$50 by the first week of February. Yahoo and Amazon both had similar, though smaller, holiday gains, followed by a slide. And as the glow of holiday cognog wears off early next year, many investors likely will be holding lumps of coal once again. "There's no justification for the run-up," says money manager Peter Doyle, who runs the Kinetics Internet Fund. "I think people are going to get their heads handed to them on these stocks."

Indeed, a little of the fear has already come out of the stocks; Amazon is now down to \$22. And even if e-commerce companies delivered perfection on their ambitious goals, it's hard to see how the current prices make sense. Amazon, for instance, sports a price-earnings ratio of 10 based on 2003 operating profits, which exclude options charges and

other expenses. Yahoo's 2003 p-e is 63, and eBay's is 58. Those all dwarf the p-e of 26 shared by No. 1 retailer Wal-Mart Stores Inc. and tech bellwether Microsoft Corp.

The stocks look all the more pricey given that even large e-tailers' sales remain just a small fraction of their land-based rivals'. Amazon's market cap of \$8.4 billion is 95% higher than the combined valuations of Barnes & Noble, Borders, and Circuit City. Yet the trio's combined sales this year are expected to nearly quadruple Amazon's \$3.9 billion. And their collective earnings, at an estimated \$279 million, easily surpass Amazon's profit, which will hit about \$51 million this year, according to Legg Mason Wood Walker Inc. The upshot is that even analysts with buys on the stocks figure there's little room for an upswing.

So what explains the recent rise? For one, a classic mistake: Individual investors often throw money at sectors that are already popular. And after the e-tail shakeout, those investment dollars are focused tightly on the few remaining big names. For now, the pros, such as mutual funds, are buying, too, perhaps because there are few other attractive places to invest.

But many likely will sell to take profits after the holidays, leaving other investors in the lurch.

To be fair, there's some method to this madness. In a dicey retail season,



HOLIDAY EXUBERANCE
STOCK PRICE WEEKLY CLOSE



online sales to date are up 29% over last year, according to market researcher comScore Media Metrix. And unlike the frothy days of 1999 and early 2000, e-tailers are logging solid results. In the third quarter, Amazon, eBay, and Yahoo all beat expectations. Says analyst Shawn Milne of Soundview Technology Group, who has buys on Amazon and eBay: "People want to find opportunities for long-term growth, and those are hard to find in this environment."

Moreover, these companies probably merit some valuation premium. Their growth rates are generally higher than those of traditional companies, and they don't require as much capital to grow as brick-and-mortar chains. E-tailers deserve credit for surviving, and for providing a little holiday cheer. But at these prices, they don't deserve more money from investors, who likely will get better returns buying milk and cookies for Santa.

Hof is Silicon Valley bureau chief.

FINANCE

GEORGE SOROS IS BACK IN THE GAME

The hedge-fund vet is again running his Quantum funds

When immense losses pummeled George Soros' Quantum Fund in April, 2000, it was, it seemed, the end of an era. Although Soros did not shutter his money-management empire, as fellow hedge-fund magnate Julian H. Robertson Jr. had done the month before, Soros reorganized his funds and even farmed out Quantum's portfolios to outside managers. Clearly, the superinvestor/philanthropist/amateur philosopher was not going to remain a force to be reckoned with in the world markets. "I no longer want to set any records," he said at a news conference.

Well, George Soros is back. And by all accounts, he seems well on his way to recouping some of his lost prestige as a world-class investor—even while grappling with a French prosecution for insider trading. The word from people familiar with Soros Fund Management LLC—whose execs, including Soros, declined to be interviewed for this article—is that the 72-year-old, Hungarian-born financier has returned to the helm. While still devoting much of his energy to far-flung philanthropic endeavors, Soros is again running his flagship \$7

billion Quantum Endowment Fund and myriad other investment vehicles. Says one veteran Soros-watcher: "He gave a line for a while that he was 70 and didn't want to gamble anymore. But none of that's true, and he's trying hard as ever to make money."

The results are impressive. Quantum gained 13.8%, vs. a 13% decline in the Standard & Poor's 500-stock index, in 2001, when the fund was largely under outside management. In 2002, with the fund back under internal management, it's down just half a percent through Dec. 6, beating the S&P by a staggering 21 percentage points. What makes the Quantum results even more impressive is what Soros didn't do to get them. He's no longer making the controversial, huge, highly leveraged

currency bets—such as his widely publicized wager against the pound in 1992—that reaped immense gains for him in the 1990s.

People familiar with his operation say that Soros has become a major player in emerging markets such as Eastern Europe. They say he has also quietly beefed up his real estate investments via a \$4.5 billion investment partnership. He still makes currency bets, but they are nowhere near as large or as risky as in the past. In the U.S., though, Soros has occasionally taken large equity stakes, SFM's holdings as of Sept. 30 included just one major equity position in his previously announced 15% stake in JetBlue Airways. "The days of the gung-ho slinging hedge funds are largely gone," says Barry H. Colvin, chief operating officer of Tremont Advisers Inc., a hedge-fund consulting firm.

The new, slimmed-down Soros approach is very much the product of a downsized, more modest, post-bull-market environment. For Soros, it all began in April, 2000, when Quantum lost 20% as a result of a disastrous, ill-timed bet on high-tech stocks. The spring market sag led to the departure of his deputy Stanley Druckenmiller, who had operated the fund on a day-to-day basis. Quantum ended 2000 down 15%.

Soros began to reverse course and pull back more from outside managers early in 2002, say people familiar with his organization. In January, 2002, he hired as chief investment officer Robert Bishop, a principal of the Maverick Capital Ltd. hedge-fund group and manager of a \$2 billion global portfolio. More recently, he announced that he was chairman of Goldman, Sachs & Co. (Asia), Mark Schwar



A NEW BUSINESS PLAN

Soros is changing his focus and the way he operates

Taking major stakes in emerging markets

Making fewer high-visibility currency bets

Operating venture capital and biotechnology funds

Managing more assets in-house, and using less leverage



the 260-hp Acura TL Type-S. Most cars simply get you from here to there. For those who enjoy the pavement between, there's the TL Type-S. It sports a robust 260-hp V-6, laser-quick acceleration, available OnStar® service near-telepathic handling. Thank you, Mr. Cartographer. Call 1-800-TO-Acura or visit acura.com.  **ACURA**

would join SFM as CEO on Jan. 1.

The top-level shuffle is emblematic of Soros' revised investment strategy. Bishop's Maverick was noted for realizing sizable returns without substantial leverage, and Schwartz's Asian experience will give a boost to SFM's efforts in overseas markets. Soros has already been making forays back into global equities, such as his participation in a consortium that took private the Irish telecommunications monopoly Eircom Ltd. More recently, he briefly took a 2 million-share stake in UAL Corp., which he cashed out as bankruptcy loomed.

Only one cloud could dim this generally upbeat picture. On Dec. 20, a magistrate in Paris will render a verdict on an insider trading case brought against

The only cloud for Soros at the moment is an insider-trading case in France

Soros and two other businessmen. Soros stands accused of trading on insider knowledge of financier Georges Pebereau's plans to attempt a takeover of Société Générale in 1988. Soros, who is vigorously fighting the charges, made about \$2 million by buying shares in the bank in September, 1988, and reselling them two months later. At the trial in November, Soros contended that he was paying a courtesy call when Pebereau told him about the plan to buy the shares, and that the pending takeover was very widely known.

The consensus in the French legal community is that the case is a slam dunk from Soros' perspective. His attorneys argue the prosecution is improper because France's insider trading laws came into effect at the end of 1989. François Lenglar, a law professor at HEC School of Management in Paris, agrees that Soros stands a good chance of acquittal. Prosecutors are seeking a \$2 million fine.

Soros doesn't exactly face the Bastille. He could pay that fine from the loose change in his sock drawer. And French insider trading convictions just don't carry the kind of consequences—such as being kicked off Wall Street—that they do in the U.S. Nope, it will take more than an overzealous Gallic prosecutor to rain on George Soros' parade.

By Gary Weiss in New York, with Christina W. Passariello in Paris

PEOPLE

WHO SAYS CEOs ARE GRINCHES?

Jeff Comment brings holiday cheer to thousands of kids

Of all the years for a CEO to play Santa, this has to be the one that truly strains credulity. After all, what self-respecting child would believe in a St. Nick with stock options, a corporate jet instead of a sleigh, and a crony-filled board willing to overlook the accounting magic tricks on Santa's wish list?

Well, there is one Santa who has proved that a CEO title need not be synonymous with self-indulgence and greed. As he has done every December since 1995, Helzberg Diamonds CEO Jeffrey W. Comment abandoned his pinstripes to dress up as Santa Claus for his annual pilgrimage, bringing good cheer to children's hospitals from Los Angeles to Philadelphia.

For Comment, 58, this is serious business. He hits the road with four red suits, six sets of hair, and a pair of black riding boots, typically greeting 2,500 children a year. The ritual began when the jewelry retailer hosted a Christmas party for a charity in Kansas City, Mo., where Helzberg—one of investor Warren E. Buffett's portfolio

1995 and heard about the annual Santa trek, he balked at first. The chairman of Berkshire Hathaway Inc. asked Comment could afford to be away a time when the business rakes in 40% of the year's profits. "By this time, everything is on autopilot," Comment said. "And the company loves it because it's not out harassing anyone." Buffett is now one of Comment's biggest fans.

Comment doesn't shy away from pleasantness. On a typical visit, he ventures into intensive care, burn unit and cancer-treatment wards. At the end of each stay, he'll usually leave the child with a teddy bear and a snapshot. Comment told, Comment has visited more than 17,000 children and formed many a memorable impression, the best of which are described in his book, *Santa's G*

What does Santa think the year's corporate misdeeds? "We lost our character," he says. "Call it greed, ego, whatever you want. A lot of people in business just forgot what they were



HITTING THE ROAD

For two weeks in the season, Comment visits hospital-bound children across the country

companies—is headquartered. Comment's job was to greet disadvantaged children as Santa. Their wishes, he found, went far beyond the latest video game: They asked Comment to reunite parents, bring home a sibling, or make a mother or father stop drinking. "I realized that Santa is much more than a mythical character who slides down chimneys," says Comment.

Comment was so taken by the reaction that he began organizing an annual tour, taking to the road for up to two weeks at the busiest time of the year. When Buffett acquired Helzberg in

responsible for." And Santa's wish for 1996? A better economy, of course, but also a new beginning for business. "All these scandals are going to help clean us up," says Comment. "I hope we don't forget them too quickly." That's a wish investors can relate to.

By John A. Byrne in New York

LOSER

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EDITED BY MONICA ROMAN

CONSECO THROWS IN THE TOWEL

HAVING FAILED TO SHORE UP its floundering finance businesses and reeling under its \$6.5 billion in debt, Conseco filed for Chapter 11 on Dec. 11. With \$52 billion in assets, Conseco is the third-largest bankruptcy ever, topped only by WorldCom and Enron. The bankruptcy is a final blow to the reputation of Gary Wendt, who quit on Oct. 3. The ex-CEO of General Electric Capital was brought in to rescue Conseco in June, 2000, with a \$45 million signing bonus. He got a further \$8 million bonus in July, 2002, a month before Conseco defaulted on its debt. The company says that its insurance units are not part of the filing and that policyholders will not be affected. Finance operations such as the risky mobile-home loan portfolio will be sold off during the restructuring. What is likely to emerge will be a life- and

health-insurance company with an investment arm.

HISTORY ON THE BASKETBALL COURT

LIKE LOTS OF OTHER SPORTS moguls, Black Entertainment Television founder Robert Johnson has money, influence, and great love of the game. Still, his winning bid for a National Basketball Assn. expansion franchise in Charlotte, N.C., is special: It marks the first time an African American has been majority owner of a major professional team. Johnson, worth an estimated \$1.3 billion, is paying about \$300 million for the as-yet-unnamed team, which will begin play in the 2004-05 season. In nabbing the franchise, Johnson prevailed over an investor group led by Boston business executive Steve Belkin and Larry Bird, a Basketball Hall of Famer.

WORLD.COM CLEARS THE DECKS

ON DEC. 17, CRITICS OF WorldCom got what they've been demanding for a long time: the resignation of 6 of the 10 sitting directors who oversaw the No. 2 telecom during a time when it misstated earnings by \$9 billion and filed for bankruptcy. Three of the six—Max Bobbitt, Francesco Galesi, and Carl Aycock—were longtime allies of ousted founder Bernard Ebbers. Also resigning were former board Chairman Bert Roberts and current Vice-Chairman John Sidgmore, who will remain at WorldCom. The departures pave the way for incoming Chairman and CEO Michael Capellas to nominate his own slate of directors. Capellas is expected to seek nominees with squeaky-clean credentials, such as former New York Mayor Rudolph Giuliani.

HEADLINER: DEBORAH HOPKINS

WINDS OF CHANGE

"Hurricane Debby" is heading toward Wall Street. On Dec. 17, Citigroup named Deborah Hopkins head of corporate strategy, making her the sixth woman on the bank's 47-member management committee.

The hard-charging Hopkins earned the nickname in the late 1990s, when she was chief financial officer of Boeing. Brought in from General Motors to stem the flow of red ink, she streamlined the airplane maker's accounting practices. But after only 18 months, she left to become CFO of Lucent Technologies in April,

2000. Just a year later, she was forced out after massive losses and an 80% stock drop.



Hopkins most recently was a senior partner at consultants Marakon Associates. Her appointment comes as Citigroup has been beefing up its management and reevaluating its business practices on the heels of federal and state probes into possible conflicts of interest at its investment bank, Salomon Smith Barney, and Congressional hearings on its dealing with Enron.

Heather Timmons and Stanley Holm

CLOSING BELL

NOT SO BOFFO

Blockbuster said on Dec. 18 that 2002 earnings could fall 20% below expectations. The culprit: slow videotape and DVD rentals. It blamed the slump on an "unprecedented" number of movies for sale at deep discounts and shoppers pressed for time in a short holiday period. The stock fell 32%, to \$13.13.



RED INK AT THE GOLDEN ARCHES

MCDONALD'S SUPERSIZE WOES got even bigger on Dec. 17, when the company warned it would suffer its first quarterly loss since going public in 1967. Fighting a price war with rival Burger King and a rising tide of complaints about bad service, the fast-food chain will take a \$390 million charge to close poorly performing restaurants and cut staff. The moves should clear the books for new CEO Jim Cantalupo, who will take over on Jan. 1. McDonald's stock, already trading at an eight-year low, tumbled 8%, to \$15.96, in the two days following the news.

CAN UAL JETTISON ITS LABOR DEAL?

UNITED AIRLINES IS TAKING off the gloves in its battle with the unions. The bankrupt

carrier disclosed that it expects to ask the court on Dec. 26 to toss out its labor contracts. United's union leaders had agreed to pay concessions of \$1 billion a year—before the airline filed Chapter 11 on Dec. 9. But United's bankruptcy lenders have given it only until mid-February to trim \$2.4 billion from annual labor bill. If it can't, the lenders are threatening to cut off their loans, which could force the airline into liquidation. The unions say they are hoping to negotiate a deal to save the company.

ET CETERA...

- Halliburton will pay \$5 billion and 59.5 million shares to settle asbestos claims.
- Vodafone CEO Christopher Gent will retire in July, to be succeeded by Arun Sarin.
- Phillips-Van Heusen agreed to acquire Calvin Klein for about \$700 million.

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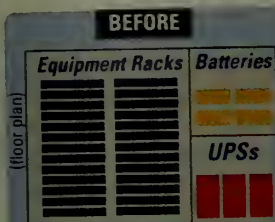
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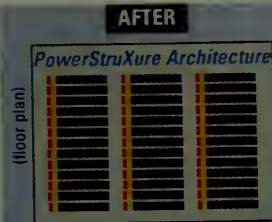
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EDITED BY LEE WALCZAK

EVEN IF LOTT GOES, DAMAGE HAS BEEN DONE

Trent Lott could learn a thing or two from Al Gore's graceful exit. Mindful that most Democratic elected officials did not want him to lead the party in 2004, the former Vice-President passed on a rematch with President Bush—thereby clearing the way for a pack of potentially more electable contenders. By contrast, the senator from Mississippi, who hopes to be Majority Leader again in 2003, has opted to put ego above party by seeking to ride out the storm over his pro-segregation musings.

The result is a nightmare for conservatives: Even if Lott bows out, George W. Bush's carefully nurtured image of inclusion could be at risk. What's more, hardliners worry that in the aftermath of an attenuated Lott fade-out, the White House may be tempted to soothe anger in the minority community by making concessions on issues ranging from affirmative action to welfare reform. "The danger is that the Administration will be more reluctant to take principled stances," frets Roger Clegg, general counsel of the Center for Equal Opportunity, a group opposed to racial preferences.

He may have reason to worry. Before the Lott debacle, the Justice Dept. was poised to support a Supreme Court case that challenges the University of Michigan's race-conscious admissions process. Now, some White House aides are urging caution. They fear that the high-profile suit could fan perceptions that the GOP is hostile to minority concerns.

Republicans also acknowledge that plans to appoint conservative judges to the federal bench could be set back amid heightened concerns over candidates' civil-rights records. For starters, Bush will be under pressure to scuttle the planned renomination of Mississippi judge Charles W. Pickering to a federal appeals court slot. Pickering is opposed by

minority activists for, among other things, trying to recede the sentence of a convicted cross-burner.

When it comes to the final haggling with Senate Democrats over the shape of a 2003 economic package, Bush could be forced to make more concessions to the Left. For instance, calls to hike the minimum wage may get a more serious look. And Democrats will try to use the controversy to wring out additional funds for Head Start, welfare, and other safety-net programs.

Despite the potential harm to the GOP agenda, thus far political damage appears to be limited. A Dec. 12-15 News Poll found that by 60% to 36%, Americans say the



EGO ABOVE PARTY: Lott's fifth apology

is committed to equal opportunity for minorities. By publicly chastising Lott, Bush has managed to avoid personal damage by not being dragged into the flap. "The Lott gaffe gave Bush the opportunity to slap him down," says David Bositis, senior research associate at the J. Morgan Kousser Center for Political & Economic Studies, a think tank devoted to minority issues. "That made Bush look better."

But all bets are off if the Lott saga drags on into January, when the President hopes to present his new political agenda. It's not so much that Bush

is losing an opportunity to raise his level of African American support, which was a puny 9% in 2000. If the controversy weakens the appeal of "compassionate conservatism" to swing voters, the GOP's lucky streak at the polls could be in risk. Indeed, the "Republicans' mood has gone from a [post-election] celebration to a funeral overnight," says Stephen MacManus, a political scientist at the University of South Florida. That probably won't change until Lott learns the basic rule of political life that Gore obviously understood: You've got to know when to fold 'em.

By Richard S. Dunham and Alexandra S.

CAPITAL WRAPUP

MR. AND MRS. JUICE

► When Vice-President Dick Cheney named Catherine Martin to replace Mary Matalin as his chief spokeswoman on Dec. 13 he made it official: Washington has a new power couple.

Cathie Martin, 34, is married to Kevin Martin, 36, one of five members of the Federal Communications Commission. They met at Harvard Law School—both are class of '93—and despite having been in Washington only a few years, have rocketed to the upper echelons of the capital power

structure. Cathie gained Cheney's confidence while accompanying him on political trips before the midterm elections, and Kevin helped vanquish Al Gore in the Florida recount battle.

After a brief stint as deputy chief of staff and White House liaison for Commerce Secretary Donald Evans, Cathie Martin served as Matalin's No. 2 for the past 18 months. Before that, the University of Texas grad worked for former Texas Attorney General (now Senator-elect) John Cornyn.

Kevin Martin earned his spurs by being on the first flight to Florida

from Austin the day after the contested 2000 election. As deputy general counsel to the Bush campaign, he oversaw the legal team working behind the scenes with the Dade and Broward County canvassing boards. His connections came in handy: He had clerked for U.S. District Court Judge William Hoeweler in Miami.

Now, Kevin Martin could hold the balance of power at the FCC, where he may be a swing vote in such crucial cases as deregulation of the Baby Bells.

By Paula Dwyer and Catherine Yang

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FORTRESS

Everywhere you look in Europe, resurgent nationalism is hindering the economic potential of a single market

EUROPE

PUTTING UP WALLS

EU members revert to protectionism

Remember when this year was billed as that magical time when Europe would really start to click? As the single currency, the single market, and expansion of the European Union ushered in vast economies of scale, waves of consolidation would roll across European industry, finance, and services, turbocharging the economy of the entire Continent.

That was the dream, anyway. It hasn't quite worked out that way. Labor rigidities, high taxes, and a European Central Bank that has kept interest rates too high for too long have all played their baleful part in keeping Europe mired in semi-recession. But there's another villain stalking Euroland these days. Call it neo-protectionism, neo-nationalism, or resurgent interventionism, it amounts to the same thing: Keep out

the competition at all costs. "That tradition, I'm afraid to say, is still alive in Europe," says Mario Monti, the European Union's competition commissioner.

It's not only alive—it's growing. Just about everywhere you look in Europe, resurgent nationalism is exacting a real economic cost. Efforts to meld Europe's patchwork of financial services into an efficient and unified whole keep running into protectionist roadblocks. Yet the European Commission reckons that enacting the measures to create a single market in financial services would add 1.1% to European gross domestic prod-

uct over the next decade and cut companies' cost of capital by as much as 0.5%. "If this is the beginning of a reversal of opening the EU, it will lead to slower productivity and slower growth," says Eric Chaney, co-head of European economics at Morgan Stanley.

But the fear of losing control of national icons is superceding the desire for growth. Just look at the shenanigans over Germany's once-mighty KirchMedia. After the group's bankruptcy in April, some of the world's biggest media investors—Rupert Murdoch's News Corp., Italy's Mediaset, and France's TF1—started sniffing around Kirch's choice assets, such as its vast and film library and 52% stake in ProSieben, Germany's largest TV broadcaster. But when bids were opened Oct. 29, KirchMedia's creditors' committee, dominated by German banks, granted exclusive rights to Hamburg-based Heinrich Bauer Verlag. It didn't matter that Bauer had scant experience in broadcasting. The important thing was that KirchMedia and ProSieben remained in German hands.

In France, the center-right government is turning out to be just as protectionist as its leftist predecessor, despite hopes that it would crack the market open further. In early December, Pöhl moved to throw a billion-lifeline to debt-burdened France T

STALLED GROWTH



—an action that has the state-controlled giant's competitors screaming at unfair competition.

Further evidence that Fortress France is thriving can be found in the way the government is making sure its key assets of floundering Vivendi remain a universal stay French. In October, the group's \$3.7 billion publishing arm was quickly bartered off to France's Groupe Arrière despite the fact that the new entity would enjoy near monopolies in books and reference books in France. Shortly after, a government-sponsored group took control of Vivendi's utility and water unit.

That's not all. In early December, Vivendi turned down a \$6.8 billion offer from Britain's Vodafone PLC for its 44% stake in Cegetel, owner of France's second-largest mobile operator. French banks ponied up enough loans to allow Vivendi to pay \$4 billion so that it could retain control of Cegetel.

Unfortunately for Europe, this neo-protectionism stands to gather even more strength. The spreading recession makes it difficult for any government to argue in favor of efficiency, since the thing voters want is more job loss. Says Morgan Stanley's Chaney: "When Europe is in recession, you have more defensive reactions from the political and corporate side."

Those who favor a more open and competitive Europe can't expect much help from Washington, either. Traditionally, the U.S. acted as a useful counterweight to the protectionist tendencies of European states. But the Bush Administration has been restrained on this issue compared with its Democratic predecessor. One big reason: Bush's decisions to protect U.S. steel groups and support American farmers with a \$10 billion aid package effectively repositioned Washington as a catalyst for market opening in Europe. "There's no way we can now criticize the Europeans with a straight face," says Peter Alexiades, a competition lawyer in Brussels with Squire, Sanders & Dempsey LLP. Moreover, just when Europe most needs a RoboCop to enforce competition, Monti and his Merger Task Force have been slapped down. The European Court of Justice in Luxembourg has returned three key antimerger decisions thanks largely to the task force's sloppy work. "There is an undercurrent of nationalism afoot in Europe at the time that EC authorities are screwing up," says Pontus Lindfelt, an antitrust expert at law firm White & Case in Brussels. The message that more competition can mean more growth is ringing on deaf ears in Europe.

By John Rossant in Paris, with David Fairlamb in Frankfurt

GERMANY

CAN DIEKMANN PLUG THE LEAKS?

First, Allianz' incoming CEO must get Dresdner into shape

It came as a bolt from the blue. On Dec. 18, Henning Schulte-Noelle announced that next April he would step down as chief executive of Europe's biggest insurance company, Munich-based Allianz, after 11 years in the job. Then came another surprise: The 60-year-old Schulte-Noelle, long considered a kingmaker in the German business Establishment because of Allianz'

Bank, which Schulte-Noelle bought for \$22.5 billion in 2001. Acquiring Dresdner was meant to produce big revenues for Allianz as insurance and banking products were marketed to the same customers. Instead, the bank turned into a money-losing nightmare. Dresdner, the third-largest bank in Germany, contributed \$1 billion to Allianz' record third-quarter loss of \$2.55 billion. Its bad-loan provisions topped \$1.8 billion.

Since acquiring Dresdner, Allianz' share price has fallen from more than \$400 to less than \$110, meaning that its market cap is less than \$26 billion—not much more than it paid for Dresdner. With the German economy slowing, the big worry now is that Dresdner will be forced to make even bigger loan-loss provisions for 2003.

Shareholders hope that Diekmann will



OLD AND NEW: CEO
Schulte-Noelle (left)
and Diekmann

MICHAEL DIEKMANN

JOB Takes over as CEO of Allianz in April, now oversees North and South America and human resources

BORN Dec. 23, 1954, in Bielefeld, Germany

EDUCATION Earned degrees in law and philosophy at Göttingen University

CAREER STOPS President of Diekmann/Thimeme publishing house in Britain, 1987-88; hired by Allianz in 1988; by 1998, he was overseeing Asia-Pacific, later adding Eastern Europe, Africa, and human resources; in current job since early 2002

FAMILY Married, three children

vast array of industrial holdings, will be replaced by a relative unknown, Michael Diekmann, 48, who now oversees the group's U.S. businesses. With the company bleeding red ink, however, investors want to see more than a new face. "A change at the top doesn't mean problems have been solved," says Yann Goffinet, a fund manager at Vontobel Asset Management Inc. in Zurich. "The company's problems remain."

Diekmann's first and most important task: to sort out the mess at Dresdner

be able to knock Dresdner into shape. Described by Schulte-Noelle as "well-trying and tested," he has a track record of solving difficult problems. It was Diekmann, for example, who oversaw the well-received Sept. 13 move to pump \$730 million into Fireman's Fund, one of Allianz' U.S. insurance subsidiaries, to cover a surge in asbestos claims. He also oversaw PIMCO funds, Allianz' successful U.S. mutual-fund subsidiary.

It could be several weeks before Diekmann unveils a strategy. But the betting is he will move quickly to sell Dresdner's investment-banking arm, Dresdner Kleinwort Wasserstein, arguing that there are few synergies to exploit

between it and the rest of the group. Then he will seek to fuse the rest of Dresdner more tightly onto Allianz. "We will do everything to integrate Dresdner Bank as quickly and effectively as possible," he says.

Despite all its ills, Allianz' insurance units are doing well. So if Diekmann does manage to set Dresdner right, Allianz could soon reemerge as a healthy financial titan. That will be the best surprise of all for investors.

By David Fairlamb in Frankfurt



GERMANY

BUSINESS HEADS FOR CHEAPER SHORES

New taxes, high wages, and red tape are driving companies out

Several times a day, a barge slowly makes its way across the Oder River from Poland to Germany, carrying a cargo upon which much of Berlin's economy rests. Literally. Aboard the vessel are freshly washed and pressed bedsheets bound for Berlin's finest business hotels.

Not that German workers aren't capable of doing laundry. In fact, Fliegel Textilservice, an overnight-linen service for Berlin hotels such as the five-star Adlon, is German-owned. But Fliegel President Hubert Emming believes that northwest Poland is a better place than Germany to do business. Polish workers typically earn less than one-fifth the wages of their German counterparts. Moreover, Fliegel's 250 workers in Nowe Czarnewo rarely call in sick, and turnover is low. "The desire to work is a lot stronger than in Germany, that's for sure," says Emming.

If things keep going the way they are, Germany will be sending out more than just laundry. Managers are deeply discouraged by what they consider to be unfair new tax laws planned by the government of Chancellor Gerhard Schröder. That only adds to the current disadvantages of doing business in Germany, such as high wages, rigid labor rules, and a smothering bureaucracy. As a result, according to a November poll by the Berlin-based Working Group of Independent Entrepreneurs, 7% of

companies surveyed, ranging from small businesses to major corporations, have already decided to leave Germany out of dismay over Schröder's policies. An additional 32% are thinking about it.

No doubt some managers are simply in shock at Schröder's unexpected tax hikes. Still, there's a real danger that German businesses will conclude that their home market is just not a good place for their capital. Domestic investment is on track to decline in 2002 for the third year in a row, and foreign investors are finding more attractive places for their money. "I'd be very surprised to hear of any company coming to Germany to build a new production facility," says Rainer Mück, tax director for General Electric Co.'s German unit.

Germany lost much of its textile and consumer-electronics industry to Eastern Europe and Asia in the 1980s and '90s. Now, in a year when Germany has a 9.7% jobless rate and more than 4 million unemployed people, the country is bracing for a new exodus. This time, signature industries such as machinery and banking could be affected. In a December survey con-

ducted by the German Machinery Plant Manufacturers Assn., 54% German machinery makers say they plan to shift some production abroad in the next two years, compared with 24% who have done so in the last two years.

Semiconductor maker Infineon Technologies, one of Germany's high-tech stars, complains that high taxes are hurting its ability to keep pace with competitors. Already, the Munich-based company has transferred bookkeeping to Portugal, and if things don't improve, headquarters could move next, CEO Ulrich Schumacher warns.

The mighty German auto companies won't abandon the country soon, but their suppliers already are: In November, Stuttgart-based Bosch announced it will move starter production to Miskolc, Hungary, where labor costs average less than \$4 an hour, compared with \$26 in Germany. Service industries such as transportation and distribution are also vulnerable as it becomes ever easier to operate just over the border in Poland, Hungary, and the Czech Republic.

In principle, there is nothing wrong with exporting jobs to second-tier countries. Living standards in those places rise, which in turn creates new markets for wealthy nations. In fact, the Polish hotel-laundry business created a new customer for Herbert Kannegiesser, a maker of industrial-washing equipment in the north German city of Vlotho. But company President Marianne Kannegiesser frets that jobs lost in Germany aren't being replaced by new ones. "That's the big danger," says Kannegiesser.

Kannegiesser continues to produce almost exclusively in Germany: No other country offers such a concentration of engineering expertise. Kannegiesser says it's unlikely he'll relocate, but won't vouch for other businesses. "At some point," he says, "the weaknesses will start to outweigh the strengths." More and more German managers think that point has already been reached.

By Jack Ewing
Frankfurt

GERMANY LOSES ITS LUSTER



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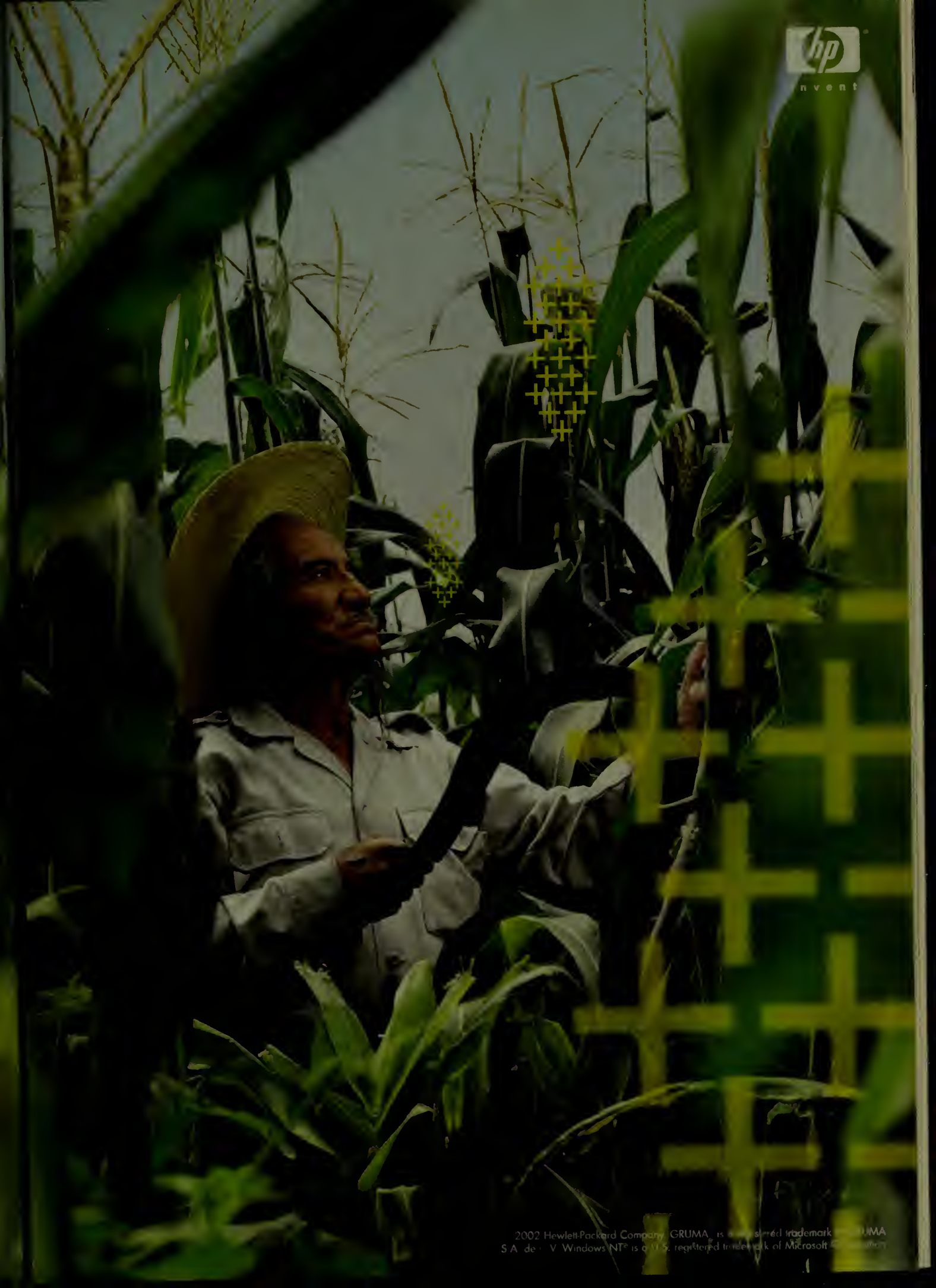
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The Way To Play This Market

For the agile and discerning, 2003 will provide a reason to smile again. **BY MARCIA VICKERS**

SOME SAY WALL STREET IS a crooked thoroughfare that begins at a churning river and ends in an old graveyard. It's a fitting metaphor for 2002—the third year of a grisly bear market. There hasn't been a time in recent memory when the stock market has been so violently roiled, destroying the fortunes of so many. Nor has Corporate America ever been shaken by such an array of scandals. Words like Enron, WorldCom, Adelphia, ImClone, Grubman, Kozlowski, and Fastow have entered the vocabulary as shorthand for corruption and greed. Even Martha Stewart—the Queen of Clean—got her hands dirty in an insider-trading scandal. Things got so bad that Wall Street became a running joke on late-night talk shows. As Jay Leno said: “Do you know the difference between Las Vegas and Wall Street? In Vegas, after you lose your money, you still get free drinks.”

The good news is that 2003 looks a few shades brighter.



CHWAST



After the market's 40% tumble over the past three years—more than half of that in 2002—many strategists expect stocks to be up in the mid-to-high single digits. "This is the kind of market where people are looking to hit a solid single, not a home run," says Charles Pradilla, chief strategist at SG Cowen Securities Corp. That may soothe investors who have lost almost half of their money in the past three years. But it won't be an easy market. Terms like "seesaw" and "meandering" pepper many strategists' 2003 forecasts. "We're still in a bear-market recovery," says Brian Belski, fundamental market strategist at U.S. Bancorp Piper Jaffray. "What the market needs to do, and what it will probably do, is end up in a big trading range next year." He thinks the market will stage several double-digit swings, making it "a very good year for active managers and stockpickers."

QUALITY IN THE BARGAIN BIN

More than ever, it's crucial to choose quality stocks. Investors need to find good, solid companies that have been beaten down mostly because of market conditions or sector scares, rather than deep-seated problems or scandals. A number of value as well as growth stocks fit that bill. Some promising 2003 picks: Wells Fargo, Cisco, DuPont, and Network Associates. As legendary investor Warren E. Buffett once said: "Our goal is to find an outstanding business at a sensible price, not a mediocre business at a bargain price."

Happily for investors, tough times in the markets have put plenty of good companies in the bargain bin. "There is a lot to be said for a bear market," says James Grant, founder and editor of *Grant's Interest Rate Observer* has said. "It clears away the debris of our preceding boom. It puts 'paid' to a lot of mistakes, and it gives people a chance to buy great companies cheap." Still, investors may need to be patient. It could take one, two, or even three years for some stocks to pay off.

That doesn't mean the market won't pick up sooner. A "Triple Crown bear market"—three straight years of falling prices—has occurred only three times since 1900, according to MarketHistory.com. In two instances, the Dow Jones industrial average rallied the following year—rising 43% in 1904 and 8% in 1942. Only during the Great Depression did the bear market stagger on for a fourth year before gaining a rip-roaring 64% in 1932.

Already, stocks have staged an im-

Instead of home runs, try hitting for average. Here's what to watch for:



1 Reasonable Valuations Look for companies with price-earnings ratios below the industry's average and low price-to-book ratios.



2 Low Prices Home in on stocks selling way below their 52-week highs—at least 25% off. The more, the better.



3 Good Growth Search for strong growth momentum. Make sure both revenues and earnings are rising—and are likely to in the future.



4 Squeaky-Clean Balance Sheet Companies that use expense options and shun pro forma numbers and gimmicks consistently outperform their peers.

pressive rally. Since Oct. 9, the Standard & Poor's 500-stock index gained 15%, the NASDAQ Composite Index 22%, and the Dow 16%. What caused the upsurge? Accounting scandals seem to have abated. Wall Street investment banks may settle with regulators over conflicted analysts' research and initial public offering allocations. The White House is promising to give the sagging economy a shot in the arm with tax cuts.

follow. But even when rates rise, stocks can perform well. The market has climbed 56 out of the 87 years since 1915. During most of them, rates were rising, too. But stocks were driven higher by rebounding earnings.

Corporate profits finally started rising year-over-year in the second quarter of 2002. In the next 12 months, earnings of S&P 500 companies are expected to grow 12%, according to Thomson First Call.

stock analysis, Benjamin Graham and David L. Dodd. They believed that stocks with undervalued assets would appreciate to their true market value. Graham, who was a mentor to Buffett, said he wouldn't buy a stock unless it had the potential to gain at least 50% within two to three years. Some other advice from the duo: It's best to buy stocks in companies which are selling for less than their intrinsic value—what the business would be worth if liquidated—such as Provident Financial and British Petroleum.

That doesn't mean investors should abandon growth stocks, by any means. It's always smart to look for stocks with strong long-

Warren Buffett's philosophy is suited to this environment: "Our goal is to find an outstanding business at a sensible price, not a mediocre business at a bargain price"

What's more, stocks are again becoming the "asset class of choice," according to Richard Bernstein, Merrill Lynch & Co.'s chief U.S. strategist. Real estate price rises seem to be flagging, and bonds could easily take a bath if the Federal Reserve raises interest rates from their 40-year lows. Some strategists say that a one percentage point rise, from 1.25%, is already priced into the market. And further hikes could

But that's pretty modest, and due mostly to cost-cutting. Some strategists don't think capital expenditures and sales growth, both harbingers of better earnings, will pick up until late 2003 or 2004.

GOOD GUYS THAT WIN

Other shackles are keeping the bull in check for now. The economy is growing relatively slowly, and unemployment has spiked higher. With the S&P trading at about 17 times estimated 2003 earnings, stock valuations may still be a tad high, despite low interest rates. (Investors are often willing to pay more for stocks when rates are low because bonds and deposits don't yield much.) The possibility of war with Iraq weighs heavily on the market, as investors take a more gingerly approach to stocks. Companies are postponing spending until the conflict is resolved, and transportation and travel-related stocks like airlines and hotels are suffering.

How do you ferret out great stocks amid this gloom? Pay heed to the wisdom of the grandfathers of fundamental

term earnings growth prospects like Cisco and German software giant SAP. It's a good idea to target companies with growing revenues. On the whole, revenues are harder to manipulate than earnings. Revenue growth should come from organic growth—customers buying merchandise at regular prices—rather than acquisitions or price discounting.

Finding companies that prize transparency and offer up good, untainted earnings numbers is also a must. Studies show squeaky-clean companies perform better than others. Baseline, an equity research company, recently started Earnings Purity indicator, which measures how much a company's announced operating earnings have been inflated by unusual write-offs over the preceding quarters. Unusual write-offs are non-recurring expenses such as acquisition charges or closing costs that are treated as if they didn't exist, thus inflating earnings. Interestingly, the companies in the S&P 500 that expected to outperform the S&P by more than six percentage points in 2002,

BusinessWeek online

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cording to Baseline. Some companies that score high on the firm's "purity" index: American Express, United Parcel Service, and Wal-Mart.

FEW SECTOR BETS

Equally important is sound trading discipline. For instance, Jack Caffrey, strategist at J.P. Morgan Private Bank who runs a U.S. equity portfolio, says he revisits a stock that drops 10% below

what he paid to see if there's a reason to sell. He sells if it falls 15%. On the upside, he reviews a stock that has gained 20% and typically sells when it's up 25%. Taking an active, disciplined approach doesn't mean market timing or day trading. As Bernard Baruch, financier and statesman, said: "Don't try to buy at the bottom or sell at the top. It can't be done, except by liars." But in this trader's market, stunts like "buy and hold" and "stocks for the long term" don't cut it, either.

Dividend stocks, in particular, are good bets. The Bush Administration's proposal to cut individual taxes on dividends already given these stocks a lift. If the plan goes through, they could really shine. Some strategists are recommending space and defense, utilities, financials, and health-care stocks. Even so, it's hard to make sector calls because the fundamental conditions of these companies are so diverse, and the recovery of capital expenditures will be happening on a company-by-company basis," says Jaffray's Belski.

What means diversification, along with quality picks, is the key. In the latest *BusinessWeek*/Harris Poll (page 76), a surprising number of investors expect stocks to perform poorly over the long run. And many think a stock crash is very likely." Back to Graham and Dodd, who believed a portfolio should be spread among at least 15 different sectors or styles. Says Michael Kenneally, chief investment officer at Banc of America Capital Management: "If you have the best company in each industry pulled them all together, you'd probably have a great-performing portfolio." Sounds simple. But first, of course, you have to find those companies. *BusinessWeek* hopes to take some of the guesswork out of it. ■

CAPITAL IDEAS

DOES THE OLD LINE "I'm from Washington, and I'm here to help you" make you pause and check you've still got your wallet? Well, in 2003, Washington may take the irony out of the joke. From tax cuts to corporate cleanup, the capital promises a busy year that could work in investors' favor.

The big show in 2003 will be economic stimulus. With his newly overhauled economic team, President George W. Bush is honing a package of tax cuts that could be worth \$40 billion in 2003, rising to almost \$300 billion over the next decade. The White House wants to speed up plans to shave the top tax rate from 38.6% in 2002 to 37.6%—or perhaps 35%—for 2003. It's also aiming to repeal the estate tax permanently, extend tax credits for research and development, and raise limits for tax-exempt contributions to 401(k) and individual retirement accounts.

Clearly, investors will benefit if Bush's **"jobs and growth"** agenda boosts the stock market. But the President has more direct aid in mind: He's likely to propose excluding some portion—perhaps 20%—of shareholders' dividend income from taxes. Eventually, Bush would like to repeal the individual tax on corporate payouts entirely. Those moves should please baby boomers, who increasingly favor stocks that pay dividends over those that reinvest profits but promise dazzling capital gains.

No amount of tax savings will draw back investors if they fear the equity markets are rigged. Companies are on notice to be more honest in 2003. Washington's

watchdogs will deploy new powers to punish miscreants and fill gaps in financial audits.

Expect the Senate to confirm Wall Street veteran William H. Donaldson as Securities & Exchange Commission chairman soon after Congress resumes work in January. Even before, Donaldson will help the commission pick a new head for the Public Company Accounting Oversight Board—whose tumultuous birth cost outgoing SEC Chairman Harvey L. Pitt his job—so it can start policing auditors by late April. Investors should take comfort if the PCAOB insists on inspecting the Big Four accounting firms itself—rather than letting them review each other—and writes its own audit standards.

Will the crisis in corporate credibility end in 2003? Only 26% of investors surveyed by the Securities Industry Assn. believe that the Sarbanes-Oxley corporate reform act of 2002 will reduce fraud. With 2004 elections looming, overcoming that skepticism is a top priority for both Congress and the White House.

Mike McNamee with Howard Gleckman



STIMULUS WANTED:

Will Bush's tax cuts bring the growth investors crave?

Now That's A Bit More Like It

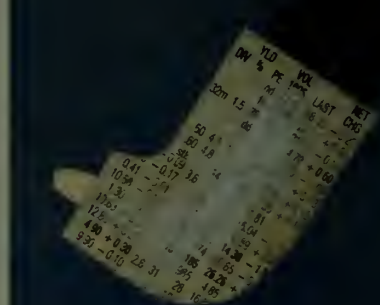
As Corporate America heals, the U.S. economy will speed up. **BY JAMES C. COOPER AND KATHLEEN MADIGAN**

IT DOESN'T FEEL much like a recovery, does it? Despite the economy's solid 3% growth rate over the past year, unemployment, at 6%, is higher than it was a year ago. Businesses can't raise prices. The stock market is down year-to-date. And consumers, company executives, and investors have little faith in the future. Will 2003 be any different?

Yes, but don't expect the patient to start doing handstands. The fractures from the stock market bust and the recession have yet to mend fully, and lingering uncertainties over terrorism and war with Iraq raise unanswerable ques-

tions about the future. Nevertheless, the economy will gain strength as the year progresses. "The coming year will feel much more like a recovery, with more consistent and more broadly based gains in economic activity," says Lynn Reaser of Bank of America Capital Management LLC in St. Louis.

That's the general view of the '66 business economists in *BusinessWeek's* 2003 Economic Forecast Survey. On average, the forecasters look for the economy to grow at about a 3% pace in the first half, with a pickup to about 3.5% in the second. Given that much of the growth will come from productivity, the rise won't be fast enough to push the unemployment rate any lower than



GLOBAL GROWTH: HOW THE U.S. STACKS UP

	REAL GDP PERCENT CHANGE			CPI PERCENT CHANGE			EXCHANGE RATE UNITS PER U.S. \$*		
	2001	2002	2003	2001	2002	2003	2001	2002	2003
KOREA	3.0	5.9	5.4	4.3	3.2	3.4	1274.00	1234.00	1199.00
MEXICO	-0.3	1.5	3.7	6.4	5.0	4.2	9.22	10.08	10.40
CANADA	1.5	3.3	3.4	2.5	2.1	2.4	1.57	1.56	1.52
U.S.	0.3	2.4	2.8	2.8	1.6	2.2	-	-	-
BRITAIN	1.9	1.6	2.6	2.1	1.8	2.5	1.43	1.54	1.55
BRAZIL	1.5	1.0	2.4	6.8	7.6	7.5	2.43	3.34	3.33
EURO ZONE	1.5	0.8	1.8	2.6	2.2	1.8	0.89	0.98	1.02
JAPAN	-0.3	-0.5	1.0	-0.7	-0.8	-0.5	124.30	126.20	125.00

Annual averages; *Britain and euro zone are U.S.\$ per unit; exchange rates are end of year

Data: Blue Chip Economic Indicators

5.7%. But the growth rate will be sufficiently solid to keep inflation at about 2.2% and boost corporate profits 9.7% (table, page 72).

TERRORIST STRIKES

Of course, the great imponderable Iraq—could throw anyone's forecast a loop. Most economists are betting on a quick and successful military outcome that brings a regime change. "That would give confidence and the financial markets a lift, bring down oil prices and boost growth in the U.S. and global economies," says Peter Hooper of Deutsche Bank Securities Inc. But what if it goes badly? "The biggest unknown is unintended consequences," says Tom Fosler of the Conference Board. That could include more terrorist strikes on the U.S., a disruption of the flow of oil or wider instability in the Middle East.

Assuming the best-case Iraq scenario, the forecasters at *BusinessWeek* are not much more optimistic about growth than the consensus. Why? First, ex-

tional City Corp. in Cleveland.

The key to this shift is an improving profits outlook. Clearly, industries such as telecommunications and airlines will hold back overall earnings, and many companies will have to pony up more for pension funds and health-care costs. However, David H. Resler of Nomura Securities International Inc. makes an essential point: "Due to strong productivity growth, unit labor costs are falling faster than prices, so profitability has improved despite a lack of pricing power." Maury Harris at UBS Warburg notes that this pattern parallels the early 1960s, a period when companies did very well with essentially no pricing power. The real benefit will come in 2003, when top-line revenue will pick up.

FINDING THE MONEY

Don't look for another investment boom, but do expect a gradual acceleration in the demand for new equipment and software that began in 2002. On average, the economists think equipment spending will rise 7.7% in 2003, more than twice the gain expected for 2002. Outlays for offices and factories

will lag behind equipment because of high vacancy rates and low capacity utilization. Outside of telecom, however, businesses have made great strides in cutting their excesses. And as growing demand lifts operating rates in 2003, new capital projects will look attractive.

Finding the money won't be a problem. Corporate cash flow is up \$112 billion during the past 1½ years, thanks to new tax allowances for depreciation enacted in March. Further business-side tax cuts are a sure bet from the Bush Administration. Plus, financing is exceptionally cheap: The bond market is increasingly liquid, and the spreads between corporate bonds and riskless Treasury issues are narrowing, a sign of better credit quality. Banks remain picky, but fewer have tightened their lending standards over the past year.

At the same time, consumers will not fade away, although their 2003 spending will not match the strong 3.7% pace of the past year. The factors that boosted spending—zero-rate financing for cars,

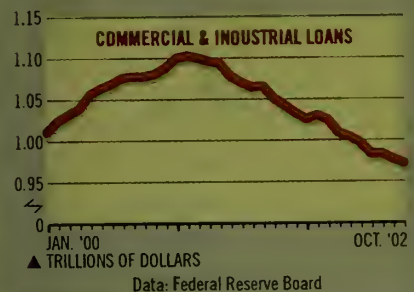
Key Indicators For 2003

Economy watchers will focus on data for the business sector, which must rev up for the recovery to show any oomph.

Capital-Goods Orders are a proxy for business sentiment. They must post at least three gains in a row and approach \$60 billion to signal a true capital-spending recovery.

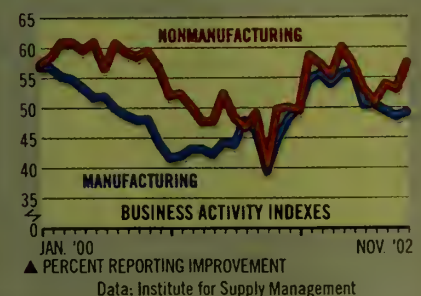


C&I Loans are used for short-term financing of inventories, supplies, and payrolls. Growth would be a sign companies are confident enough to start borrowing again.



Business Activity Indexes

from the Institute for Supply Management must rise well above 50% to indicate that a broad-based business recovery is in place.



ally stimulative monetary and fiscal policy and the strongest productivity gains in three decades will buoy demand by helping to lift company profits and household buying power. Second, prices of goods in the early stages of production are already accelerating, suggesting that pricing power is likely to pick up. Third, and most important, as the year progresses, stronger demand and profits will spur businesses to hire more workers and shell out more for capital projects. Weakness in those two areas is what has so far prevented this recovery from feeling like the real thing. That will change in 2003, when Corporate America begins to shoulder more of the load of getting the economy moving. Businesses have pared down excess capacity and inventories and are adjusting to the new realities of higher risk and of increased corporate accountability. As a result, "one aspect of the expansion in 2003 will be its switch from consumer-led to business-led," says Richard J. DeKaser of Na-

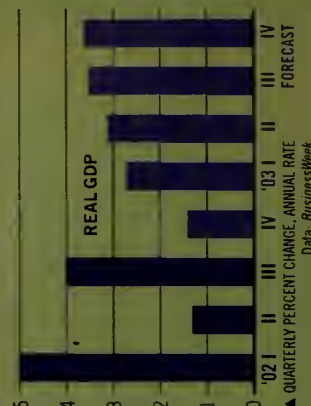
What the Seers See for 2003

The BusinessWeek Economic Survey

We asked 66 thinkers on the front lines of business—including BW's Business Outlook editors Jim Cooper and Kathleen Madigan—to divine the economic future. Here are some color-coded highlights from the survey, compiled by James Mehring:

NAME/FIRM	QUARTERLY PERCENT CHANGE REAL GDP ANNUAL RATE 2003				YEARLY PERCENT CHANGE 2002 Q4 TO 2003 Q4			2003 Q4 LEVELS		
					REAL GDP	OPERATING PROFITS*	CPI INFLATION	FEDERAL FUNDS RATE	10-YR. TREASURY YIELDS	JOBLESS RATE
	I	II	III	IV						
IAN SHEPHERD ON High Frequency Economics	4.0	4.5	5.0	5.0	4.8	30.0	1.8	2.50	5.25	6.5
JAMES SMITH Society of Industrial and Office Realtors	3.8	4.3	6.0	5.5	4.7	22.2	1.2	2.65	3.82	4.8
GAIL FOSLER The Conference Board	4.2	3.1	4.1	5.2	4.1	2.0	2.3	2.16	5.10	5.2
MICHAEL ENGLUND MMS International	4.0	4.0	4.0	3.5	3.9	12.2	2.4	3.00	5.65	5.4
JAMES COOPER & KATHLEEN MADIGAN BusinessWeek	3.5	3.5	4.0	4.0	3.8	9.0	2.0	1.75	5.00	5.4
RICHARD DEKASER National City	3.0	3.2	4.6	4.6	3.8	3.5	2.8	1.97	4.89	5.5
KURT KARL Swiss Re	3.2	3.6	4.2	3.9	3.7	12.0	2.0	2.25	5.30	5.5
RICHARD RIPPE Prudential Securities	3.2	3.5	3.9	4.3	3.7	14.6	2.5	2.60	4.90	5.5
NARIMAN BEHRAVESH Global Insight	3.1	3.2	3.7	4.4	3.6	8.5	2.3	2.31	5.90	5.6
HENRY WILLMORE Barclays Capital	3.5	4.5	4.5	2.0	3.6	6.0	2.6	1.85	4.75	5.6
ROBERT BRUSCA Native American Securities	3.1	3.6	3.8	3.5	3.5	9.0	1.8	1.25	4.35	5.7
STEPHEN GALLAGHER Société Générale	4.1	3.1	3.6	3.6	3.5	12.0	2.3	2.00	4.85	5.4
MAURY HARRIS UBS Warburg	2.5	4.5	3.5	3.5	3.5	6.9	2.3	2.10	4.90	5.5
PETER HOOPER Deutsche Bank Securities	2.0	4.0	4.0	4.0	3.5	8.0	1.3	2.15	4.90	5.6
DANIEL LAUFENBERG American Express	3.2	3.0	3.5	3.9	3.5	7.5	3.1	2.60	5.00	5.4
CONSTANTINE SORAS Andrew Alexander Wise & Co.	3.2	3.1	3.8	4.4	3.5	5.2	2.4	2.05	4.60	5.5
RICHARD BERNER Morgan Stanley	2.5	3.8	3.9	3.5	3.4	12.0	2.2	2.13	4.80	5.5
BRUCE KASMAN / ROBERT MELLMAN J.P. MorganChase	3.0	3.0	4.0	3.5	3.4	7.0	1.4	1.40	4.78	5.7
MARK LIEBERMAN Washington Mutual	2.7	3.1	3.7	3.8	3.4	15.0	2.6	1.93	4.72	5.7
JOEL NAROFF Naroff Economic Advisors	3.4	3.6	2.8	3.4	3.4	12.5	2.2	2.75	5.80	4.3
LYNN REASER Banc of America Capital Management	2.6	3.5	3.8	3.7	3.4	7.7	2.3	2.50	5.00	5.6
SUNG WON SOHN Wells Fargo	2.0	3.7	3.8	3.8	3.4	10.0	2.0	2.25	5.25	5.6
EARLY TWAYER A.G. Edwards	2.5	3.5	3.0	4.5	3.4	9.0	2.3	2.10	5.00	5.2

AS NEXT YEAR UNFOLDS, GROWTH WILL IMPROVE



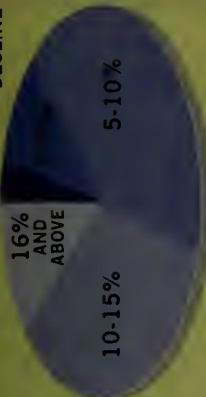
A JOBLESS RECOVERY

Ian Shepherdson is at the top of the list with his GDP forecast but has the unemployment rate at a curiously high 6.5% for the end of 2003. Says Shepherdson: "The strength of

NUMBER OF RESPONDENTS

■ 2 ■ 6 ■ 25 ■ 21 ■ 7

DECLINE



Data: BusinessWeek

INFLATION LOOKS TAME

Any war-induced jump in oil prices will be short-lived. Inflation forecasts for the first half of 2003, when any conflict in Iraq would occur, call for subdued price pressures. But as Neal Soss puts it, economists "have no special insight into Saddam Hussein's thought process."

WAIT FOR NEXT SUMMER FOR THE FED'S FIRST HIKE

PROJECTED MONTH OF FIRST INTEREST-RATE INCREASE

PROJECTED MONTH OF FIRST INTEREST-RATE INCREASE	% OF RESPONDENTS
MAY, 2003, OR EARLIER	16
JUNE	21
JULY	10
AUGUST	21
SEPTEMBER	13
OCTOBER OR LATER	11
NONE	8

The consensus sees the Fed hiking interest rates in the summer of 2003, but eight see rates going lower. Of them, Ken Logan and Ian Morris don't see any hikes following early 2003 cuts. Reasons: Logan believes companies will continue to pare spending, while consumers become more frugal.

Charts by Laurel Daunis-Allen/BW

JOSEPH LIRU Stone & McCarthy Research	2.0	3.0	4.0	4.2	3.3	11.0	2.7	1.75	4.75	5.4
JOHN LONSKI Moody's Investors Service	3.5	2.9	3.4	3.5	3.3	10.0	2.7	3.80	5.50	5.5
KEN MAYLANO ClearView Economics	3.1	3.5	3.1	3.4	3.3	10.5	2.5	2.18	4.78	5.4
JOEL PRAKKE / CHRIS VARVARES Macroeconomic Advisers	2.6	3.4	3.7	3.7	3.3	6.7	1.7	2.23	4.64	5.6
DAVID RESLER Nomura Securities International	2.6	3.1	3.7	3.8	3.3	10.5	1.8	1.73	4.56	5.7
ROBERT MCGEE / THOMAS SYNNOTT U.S. Trust	2.8	2.9	3.5	3.8	3.3	10.0	1.8	1.67	4.50	5.6
BILL CHENEY John Hancock Financial Services	2.4	2.8	3.2	3.9	3.2	10.0	2.0	2.25	4.75	5.6
ROBERT SCHNORBUS J.D. Power and Associates	2.6	3.1	3.6	3.8	3.2	12.0	2.2	2.20	4.60	5.6
OIANE SWONK Bank One	3.3	2.9	3.4	3.4	3.2	20.8	2.0	1.80	4.10	6.1
STEVEN WOOD FinancialOxygen	3.0	2.5	3.5	3.8	3.2	7.5	2.1	2.50	4.90	5.6
WAYNE ANGELL Angell Economics	2.0	3.0	3.5	4.0	3.1	15.0	1.8	1.25	3.75	5.8
MICHAEL CAREY Credit Lyonnais	2.3	2.8	3.6	3.6	3.1	8.9	2.0	1.83	5.10	5.6
STUART HOFFMAN PNC Financial Services Group	2.8	3.0	3.2	3.5	3.1	10.5	2.8	1.90	4.50	5.5
JOHN SILVIA Wachovia	2.8	3.1	3.1	3.4	3.1	18.4	1.8	1.75	5.25	5.7
DAVID WYSS Standard & Poor's	2.5	3.7	3.4	3.0	3.1	9.8	2.4	1.30	4.60	5.7
ANTHONY CHAN Banc One Investment Advisers	2.6	2.9	3.0	3.4	3.0	10.5	2.3	1.50	4.35	5.5
ETHAN HARRIS Lehman Brothers	1.5	3.0	3.5	4.0	3.0	NA	2.2	2.00	4.50	6.1
KEITH HEMBRE US Bancorp Asset Management	3.5	2.5	3.0	3.0	3.0	7.5	1.5	1.50	4.50	5.9
MICHAEL MORAN Daiwa Securities America	2.4	2.9	3.1	3.4	3.0	8.0	1.9	1.75	4.60	6.1
STEVEN RICCHIUTO ABN AMRO	2.1	2.4	3.4	4.2	3.0	5.2	2.2	1.50	5.20	5.8
ROBERT SHROUOS DuPont	2.5	3.0	3.0	3.5	3.0	14.0	2.1	1.50	4.75	5.8
VINCENT BOBERSKI RBC Dain Rauscher	2.3	2.6	3.2	3.5	2.9	5.5	2.0	2.75	4.90	6.2
MARK ZANOI Economy.com	2.4	2.6	3.0	3.4	2.9	-3.5	2.0	2.72	4.76	6.2
NICHOLAS PERNA Perna Associates	2.1	3.0	2.9	3.1	2.8	9.8	2.6	2.33	4.94	5.4
NEAL SOSS CSFB	3.0	2.6	2.8	2.6	2.8	7.9	3.2	1.25	3.55	5.8
DONALD STRASZHEIM Straszheim Global Advisors	1.0	2.0	4.0	4.0	2.8	13.0	2.0	2.50	4.80	5.6
BILL OUDLEY Goldman Sachs	1.5	2.5	3.0	3.5	2.6	12.9	1.4	1.50	4.70	6.1
MICHAEL NIEMIRA Bank of Tokyo-Mitsubishi	2.0	2.7	2.8	3.1	2.6	4.1	2.8	1.75	5.00	5.4
JOHN POPE Investment Economics	1.6	2.5	2.8	3.1	2.6	3.5	2.3	2.00	5.00	6.0
RICHARD YAMARONE Argus Research	1.5	3.3	3.2	3.3	2.6	20.0	3.5	2.50	5.75	5.5
JOSHUA SHAPIRO Maria Fiorini Ramirez	2.6	2.0	2.5	2.7	2.5	10.0	1.7	1.75	4.75	6.2
JIM COONS Huntington National Bank	1.6	2.1	3.3	2.8	2.4	7.7	2.4	2.62	4.89	5.3
ALLEN SINAI Decision Economics	2.3	2.1	2.5	3.1	2.4	4.6	2.2	1.87	4.40	6.2
KEVIN LOGAN Dresdner Kleinwort Wasserstein	1.2	1.5	1.8	3.1	1.9	6.0	1.4	0.75	3.80	6.6
IAN MORRIS HSBC	1.5	1.5	1.5	1.5	1.5	-4.0	1.5	0.75	3.60	6.5

CONSENSUS

2.7% 3.1% 3.5% 3.6% 3.2% 9.7% 2.2% 2.0% 4.8% 5.7%

* Before-tax corporate profits with IVA and CCA (NIPA BASIS)

tax cuts, and cashouts from a record volume of home refinancing—will be gone, and households will be saving more because of lost stock market wealth. “That said, the 94% of the labor force that is gainfully employed is seeing rising real wages, which will be sufficient to sustain a moderate pace of consumer spending,” says Michael P. Carey of Crédit Lyonnais. Aftertax household income is up 3% from a year ago.

BELT-TIGHTENING

Consumer spending elsewhere in the world will be a lot weaker, however, implying only moderate global growth (table, page 70). Despite the European Central Bank's latest interest-rate cut,

real rates in the euro zone remain much higher than in the U.S., and the region faces fiscal belt-tightening in 2003, especially in Germany. Japan will continue to struggle with deflation and the negative impacts from bank reform. The rest of Asia has performed well, and the outlook there depends mainly on the U.S., which will be getting enormous support from the Federal Reserve.

Now that the Fed has achieved price stability, which is every central banker's Holy Grail, it can keep policy stimulative for an unusually long time in an effort to insure against deflation and get the economy moving faster. The Fed will wait for

stronger job growth before lifting interest rates toward a level that will foster continued price stability in 2004 and beyond. “Mr. Greenspan will want the recovery to have deep roots before it pours even a small dose of weed-kill on it,” says Ian Shepherdson of High Frequency Economics.

The consensus of economists is that the first Fed hike will come in the second half. Until then, lower interest rates—the economy's Miracle-Gro—plus the ebbing of uncertainty will allow the recovery not only to put down deep roots but to flower as well.

FORECASTERS

GENE HUANG: A NEAR-PERFECT DELIVERY

Recall the dark mood of a year ago. The nation was recovering from the September 11 attacks, a war raged in Afghanistan, and the economy was in recession. But Gene Huang, chief economist at shipping giant FedEx Corp., was convinced the U.S. economy would forge ahead. That confidence made Huang *BusinessWeek's* most accurate forecaster for 2002 (table).

One key to Huang's accuracy was the trend in interest rates. Because short-term nominal rates fell below inflation by the end of 2001, consumers' real borrowing costs were negative. Auto makers' zero-rate financing amounted to a windfall for millions of consumers. “You were actually being rewarded for buying a car,” says Huang. Businesses weren't so lucky. Because producer prices were falling, companies found their real borrowing costs rising. Huang foresaw this, too, correctly projecting that capital spending wouldn't perk up in 2002.

It's rare for an industrial economist to best his financial-market brethren, but Huang says working for FedEx gives him an edge over Wall Street and bank economists. Since FedEx serves every sector and region, “I have a detailed look at the economy,” he says. “It's almost like an internal Beige Book,” referring to the Federal Reserve's report on regional economic activity.

Huang, a native of China, reaches back to his roots to explain



LOOKING UP NEXT YEAR:

FedEx' Huang figures there'll be less financial volatility in 2003

his 2003 outlook. In the Chinese calendar, he says “2002 was the Year of the Horse. 2003 is the Year of the Ram.” **Huang describes the horse as strong but difficult to control, while the ram is more surefooted.** He expects a more stable

economy in 2003, with less-volatile financial markets, reduced geopolitical uncertainties, and a more coordinated focus in Washington on economic policy.

Huang, 39, graduated from Shanghai's prestigious Fudan University, where he met his wife, Christine X. Jiang, now a finance professor at the University of Memphis. When he's not

following interest rates or FedEx deliveries, Huang enjoys playing the piano and painting. He's modest about his artwork, but when it came to the 2002 U.S. economy, Huang painted a very flattering portrait

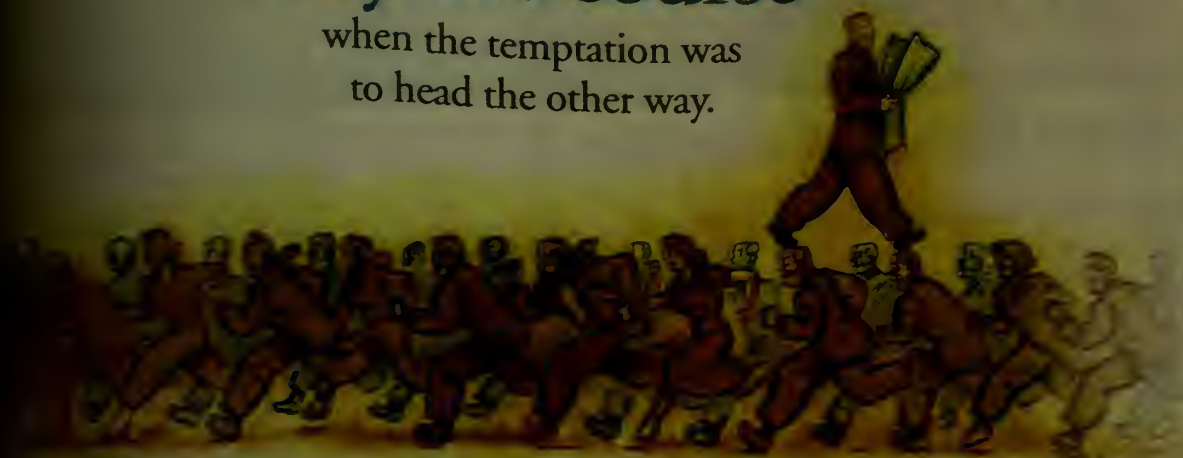
Kathleen Madigan

Huang's Savvy Forecast of 2002

	REAL GDP (% CHANGE, ANNUAL RATE)				YEARLY CPI	FED FUNDS RATE	10-YR TREASURY	JOBLESS RATE
	1Q	2Q	3Q	4Q*	3Q	3Q	3Q	3Q
HUANG'S FORECAST	-1.2%	1.7%	3.7%	4.0%	1.6%	2.2%	4.4%	6.1%
ACTUAL	5.0	1.3	4.0	1.4	1.6	1.74	4.3	5.7

* Not scored. Actual is the average expectation in the 2003 *BusinessWeek* survey

How a long-term
strategy helped an investor
stay the course
when the temptation was
to head the other way.



You can always tell how investors feel about their financial plans. Just watch how they react when the markets become unpredictable. People counting on short-term results and heavily weighted in one market segment are often anxious to make changes. Investors with long-term strategies and diversified portfolios are more likely to remain confident and stay the course.

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Good Morning, Heartache

Investors are more bearish than they've been since at least 1996. Ironically, that may actually be a harbinger of better times. **BY PETER COY**

HAVE DISGUSTED small investors finally thrown in the towel? Despite the rally in the stock market from its early-October lows, they're more pessimistic now than they have been at any yearend since at least 1996, according to the annual *BusinessWeek/Harris* Poll on the investment outlook.

It's no surprise that the bear market has taken its toll, but the sheer in-

right, it could be a good time to buy.

Whatever the interpretation, the facts are clear: **After enduring a bear market for close to three years, investors are sick and tired of Wall Street.** The poll asked the opinions of just over 1,000 people, including 575 who said they own stocks. It's a snapshot of what the average investor—not the professional—is thinking. The complete results are available at www.businessweek.com.

The most striking finding is the diminished expectations that investors have for long-run total returns from the

simistic category soared to fully 2. Meanwhile, the group who expect at least 12% annual returns fell from 40% in 1998 to just 12% this year. In another cut at the issue, 36% of investors regard the stock market as overpriced even today's depressed levels, vs. 19% who think stocks are cheap. Investors gave similar answers when asked about technology stocks and international stocks, with more describing them as overpriced than as cheap. Half of investors think terrorism and the war against it will affect the stock market somewhat or

negatively in the coming year, up from 40% last year, up from 40% last year, up from 40% last year.

The bear market seems to have made a dent in investors' confidence in their stock-picking skills. Most think they can beat market averages, but fewer think so now than in the past. Ten percent are "very confident," 54% are "somewhat



53%

think real estate is the best investment

tensity of investors' gloominess is remarkable. In the poll, conducted Dec. 6-9, more people than at any time in the last seven years predicted ultra-low long-run returns from stocks, more said a stock crash was "very likely," and more said real estate was likely to be a better investment than stocks. There were similar results for some newer questions: Fewer people say they've bought shares lately, fewer plan to buy any soon, and fewer are confident of their ability to beat the market.

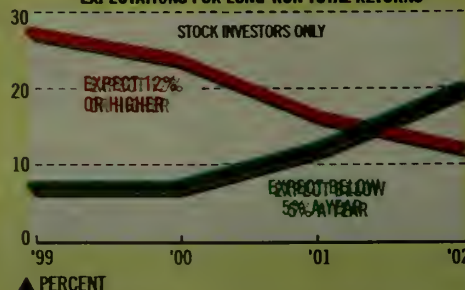
To some observers, the dark mood of small investors is evidence that there's no foundation for a rally to build on. But contrarians argue just the opposite. They say that investors have probably already acted on their pessimism by dumping shares, so the market has nowhere to go but up. If they're

stock market—capital gains and dividends combined. The portion of investors who expect total returns of less than 5% fluctuated in the single digits from 1996 to 2000 before jumping to 12% last year. This year the share in that most pes-

sident" that their picks will top the market averages, down from 17% and 6% respectively, in 2000. The share of those who are not at all confident of their market-beating ability is up to 8% from 3% in 2000.

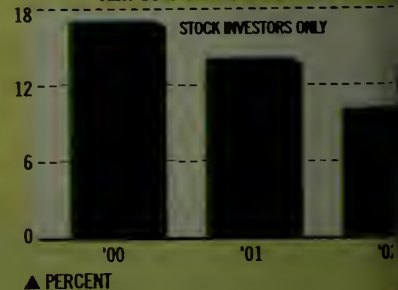
INVESTORS HAVE LOWER EXPECTATIONS...

EXPECTATIONS FOR LONG-RUN TOTAL RETURNS



...AND DON'T THINK THEY CAN BEAT THE MARKET

VERY CONFIDENT OF BEATING THE MARKET



Investors are acting on their dark convictions, too. Only 50% say they've bought stock or mutual-fund shares in the past 12 months, down from 60% who said so in 1999. And only 17% say they plan to invest "a lot" or "somewhat" more in stocks or mutual funds in the coming six months. That's down from 47% in 1999.

Each year we ask some questions of all households, not just ones in which people say they own stock. This broader group is equally negative. Over the next year, 56% say, another big crash in the stock market is very or somewhat likely. That ties 1997 for the highest level in the poll's history. (For what it's worth, the 1997 prediction came out: The market did take a big tumble in the fall of 1998.) Only 41% expect stocks to go up in the year ahead. While that's in line with the lev-

8%
are "not at all confident"
they can beat the market



able assets of most American families. Still, as recently as 1999, just 30% of respondents singled out real estate as the best investment. Mutual funds and common stock combined fell over the same period from 33% to a measly 14%. Stock-owning families tilted just as strongly toward real estate as households in general, with 55% picking it as their favorite choice and 19% opt-

tainly the message you get from reading the poll results at face value.

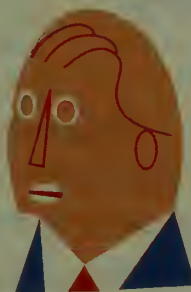
But it's possible that reading the poll results literally will leave you standing on the platform as the rally train leaves the station. Contrarians see the miasma of pessimism as proof that investors have finally "capitulated"—that is, given up all hope. They see capitulation as a prerequisite for a rally, on the grounds that when there are no optimists left, there's no one left to drag the market down by turning pessimistic. At that stage—now, perhaps?—the only change possible is for some of the pessimists to turn optimistic, driving stock prices higher.

Meir Statman, a finance professor at Santa Clara University, sides with the contrarians in regarding the *BusinessWeek/Harris Poll* as a potential buy signal. "**Sentiment is useful as a contrary indicator,**" says Statman. "I would not say from that that you should mortgage your house and jump into stocks, but I would say, don't join this overall pessimism."

In predicting trouble ahead, our poll respondents may be guilty of a common investing sin: assuming that what happened in the recent past will just keep on happening. "They're just grabbing at what they last saw or what they last experienced," says Frederick W. Stanske, a senior vice-president at Fuller & Thaler Asset Management Inc. in San Mateo, Calif. Ronald D. Peyton, CEO of San Francisco-based investment consulting firm Callan Associates Inc., questions respondents' views that real estate is a better investment today than the stock market is. Says Peyton: "**There's more risk in real estate than there is in mutual funds at this point in the cycle.**"

No poll is going to reveal the next move for the stock market, of course. Prices are simply too unpredictable. But if you're looking for any edge you can find, it wouldn't hurt to chew over these results.

17%
think a big stock crash is
"very likely" in 2003



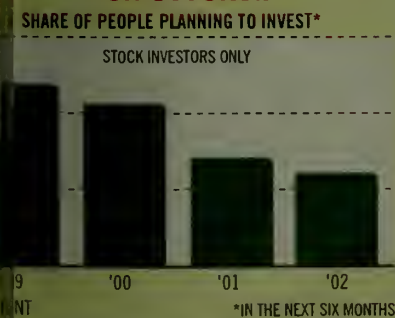
of the late 1990s, it's well down from 52% who were expecting an up year 18 months ago.

Disillusioned by Wall Street, people seem to have hitched their hopes to real estate. Fully 53% of households named real estate as the single best investment choice. That is by far the highest in the history of the poll, which dates back to 1989 and 1996-2002. (The run-up year was 1989, at 40%.) Real estate has always been popular, probably because houses are the most valu-

ing for common stock or mutual funds.

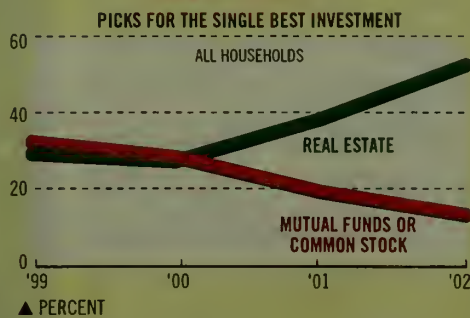
What do these results imply for the fortunes of the stock market in the coming year? According to the bearish view, the poll shows that small investors have been so badly burned by the stock market that they won't come back anytime soon. They're more worried about getting fooled again than about missing a rally, this theory goes. And as long as the great mass of the investing public remains on the sidelines, the market will move mostly sideways. That's cer-

...SO FEWER ARE BETTING ON STOCKS...



Data: Telephone survey of 1,004 adults, including 575 stock investors, conducted Dec. 6-9 by Harris Interactive Inc. The margin of error for stock investor responses is plus or minus 4%.

...PREFERRING REAL ESTATE



Picky, Picky, Picky

The rising tide won't lift all boats, so choose stocks with extreme caution.

CAN YOU SAY "I'm a stockpicker"? If not, you may miss out on the best opportunities of 2003. The year is likely to bring a rising tide for the economy and financial markets—but it won't lift all boats. So choppy markets and a slow recovery will force you to pick sectors and companies within them with great care. Best bets? Think "dull." Cyclical industrial stocks—including chemical and heavy-equipment makers—should see a strong year (page 90). Abroad, the Old Economy is looking up (page 98). Even within sectors, dull may be better: In energy, think coal, not oil (page 86). But there are hot prospects in industries with a little more *joie de vivre*. In media, there's hope that the rebound in TV advertising will spread (page 88). Drugmakers see a faster flow of new products from research pipelines (page 83). And after five years of falling capital investment in technology, tech investors have nowhere to go but up—provided they stick with the big names Corporate America depends on (page 79). Even for gamblers, selectivity is key: Casinos reachable by car will outpace fly-in resorts (page 96). It's that kind of fine focus that could make your portfolio grow. ■

Go for Tech's Tried and True

There are good reasons for NASDAQ's recent surge. But niche players aren't one of them. **BY DEAN FOUST**

IBM AND MICROSOFT Corp. trotted out surprisingly strong third-quarter earnings, and investors jumped at the chance to rekindle an old flame, tech stocks. Since its 2002 low on Oct. 9, the tech-laden NASDAQ index is up 22%.

That's not purely a case of hope triumphing over reality. After cutting tech spending for five years, businesses need to start buying again. Be careful, though. With stocks—as with old flames—nostalgia is the mother of disillusion. The bubble babies now trading at \$1 a share are no bargain. But some tech titans, lean and recession-toughened, are buys. “You have to own the dominant companies—the Ciscos, the Microsofts—because they’re going to be the ones that gain market share in this environment,” says Steve Galbraith, Morgan Stanley’s chief U.S. equity strategist.

That’s happening now in software. Companies are putting their tech dollars only into essential programs, delaying purchases from niche companies.

That’s why Arnie Berman, tech strategist for SoundView Financial Group Inc., an investment boutique based in Old Greenwich, Conn., believes German giant SAP’s revenues will boom. Once companies install SAP programs, which let them monitor production, they rarely switch, he says. Many are overdue for an upgrade. “I’ve talked to lots of manufacturers who have postponed upgrades of SAP for so long that they’re now running versions that SAP doesn’t support,” says Berman. At \$20, the stock has doubled since early October, but it’s still worth just a quarter of its March, 2000, peak. Assuming a recovery, Berman thinks the stock will likely

hit the low 30s in the next 12 months.

Market dominance and price are big reasons to buy **Microsoft** now that it has settled antitrust allegations with the government. Value investor Henry J. Herrmann, chief investment officer at Waddell & Reed Financial Inc., a \$29 billion fund family, rarely buys tech. But Microsoft is now his fourth-largest holding. Why? It trades at the same price as it did in May, 1998, when the government filed its suit. Analysts see a surge in revenues as companies upgrade PC operating systems from Microsoft’s Windows 98 to Windows XP, which is expected to require less maintenance. Also, Microsoft can now branch into areas such as online services, where it once felt constrained by the suit. The big hope: With \$40 billion in cash, Microsoft—which pays no dividend—may pay one if Congress eliminates double taxation of dividends. “Microsoft could easily afford to pay out 30% of its earnings in dividends,” Herrmann says.

Pent-up demand is raising revenues for recession-toughened tech titans—especially in the software sector

Money managers believe that **Cisco Systems Inc.**, like Microsoft, will expand at its rivals’ expense. It has a strong product mix and \$21 billion in cash. Despite the drop in demand for its computer networking products—which slashed its stock price by 83%—Cisco generates \$1 billion in cash each quarter and has gross margins of 69%. UBS Warburg tech strategist Pip Coburn believes that Cisco can offset weak networking with storage, security, and telecom software. “Cisco has a real chance to gain meaningful and profitable share in telecom,” he says.

Security software also falls under the rubric of essential spending, given con-



cerns about hackers and terrorists. That's why Alan Weinfeld, an analyst with Fulcrum Global Partners LLC, a New York research firm, likes Santa Clara (Calif.)-based **Network Associates Inc.**, maker of the well-known McAfee antivirus software and a turnaround play. Now around \$15, the stock fell below \$2 in early 2001. The new CEO, IBM veteran George Samenuk, has focused on markets where the company is a leader, landing antivirus software contracts with Dell Computer, AOL Time Warner, and Sony. A new product that heads off network crashes is also

a hit. Weinfeld believes that Network Associates could earn at least 75¢ a share in 2003, vs. 66¢ for 2002—giving it a price-earnings ratio of 21. "We're confident in management, confident in the products, and the valuation is attractive," he says.

Most analysts are wary of semiconductor companies because wireless-phone makers, which are big buyers, are in the dumps. But Berman, the Soundview strategist, sees value in **Taiwan Semiconductor Manufacturing Co.**, a leading contract foundry. TSMC's stock collapsed last summer when orders from a key customer, Nvidia Corp., plunged. But it quickly replaced that business. November revenues were up 32% year-on-year, thanks to outsourcing from other chipmakers. With its "leading-edge production capabilities and lower-cost structure," TSMC has the edge on rivals, Berman says.

The key thing for investors to remember, as those tender feelings creep back: Don't get swept off your feet. There's overcapacity in telecom equipment, network servers, and business software. Many companies are still pricey, assuming earnings growth of 5% or less. Merrill Lynch & Co.'s Tech 100 index is trading at 35 times projected 2003 earnings—half of its peak but still twice the average p-e in 1996. Apply Mom's advice on love. Go for the good providers. And stick with them. ■

Leaning on the Tech Pillars

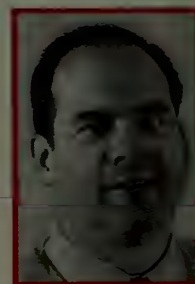
COMPANY/SYMBOL	PRICE*	P-E RATIO**
CISCO CSCO	\$13.40	22
Leveraging dominance in network software to push into security programs and PBX systems		
DELL DELL	26.63	28
Its PC market share is growing and it's expanding into printers and servers		
MICROSOFT MSFT	52.50	25
After settling antitrust charges, it's pushing unfettered beyond its core PC software		
SAP SAP	20.04	27
Expected snapback in factory spending plays into SAP's hands		
TAIWAN SEMICONDUCTOR TSM	7.70	29
Its large foundry is profiting from trend to outsource chip production		

*Dec. 13 **Based on forecast earnings for fiscal 2003

Data: Bloomberg Financial Markets, *BusinessWeek*, I/B/E/S

Q&A

OPPORTUNITY CALLING



As an aide to Secretary of State James A. Baker II in the early 1990s, **Scott C. Cleland** specialized in telecom policy. Now CEO of Precursor Group,

he projects a brighter year, particularly for regional Bells, thanks to shifts he sees at the Federal Communications Commission and industry reshuffling.

Q: What's the outlook for 2003?

A: The story is that telecom bounces back from the bottom.

Q: Couldn't the WorldCom bankruptcy launch a price war that drags down the industry?

A: WorldCom Inc. won't survive independently long term. We're just waiting for it to complete the archaeological digs into its financial records. It'll probably be spring or summer before it has its books in order, but it'll be acquired sometime after that. They've got to merge to lower costs. Both WorldCom and AT&T are likely to get merged into a Bell.

Q: AT&T is takeover bait, too?

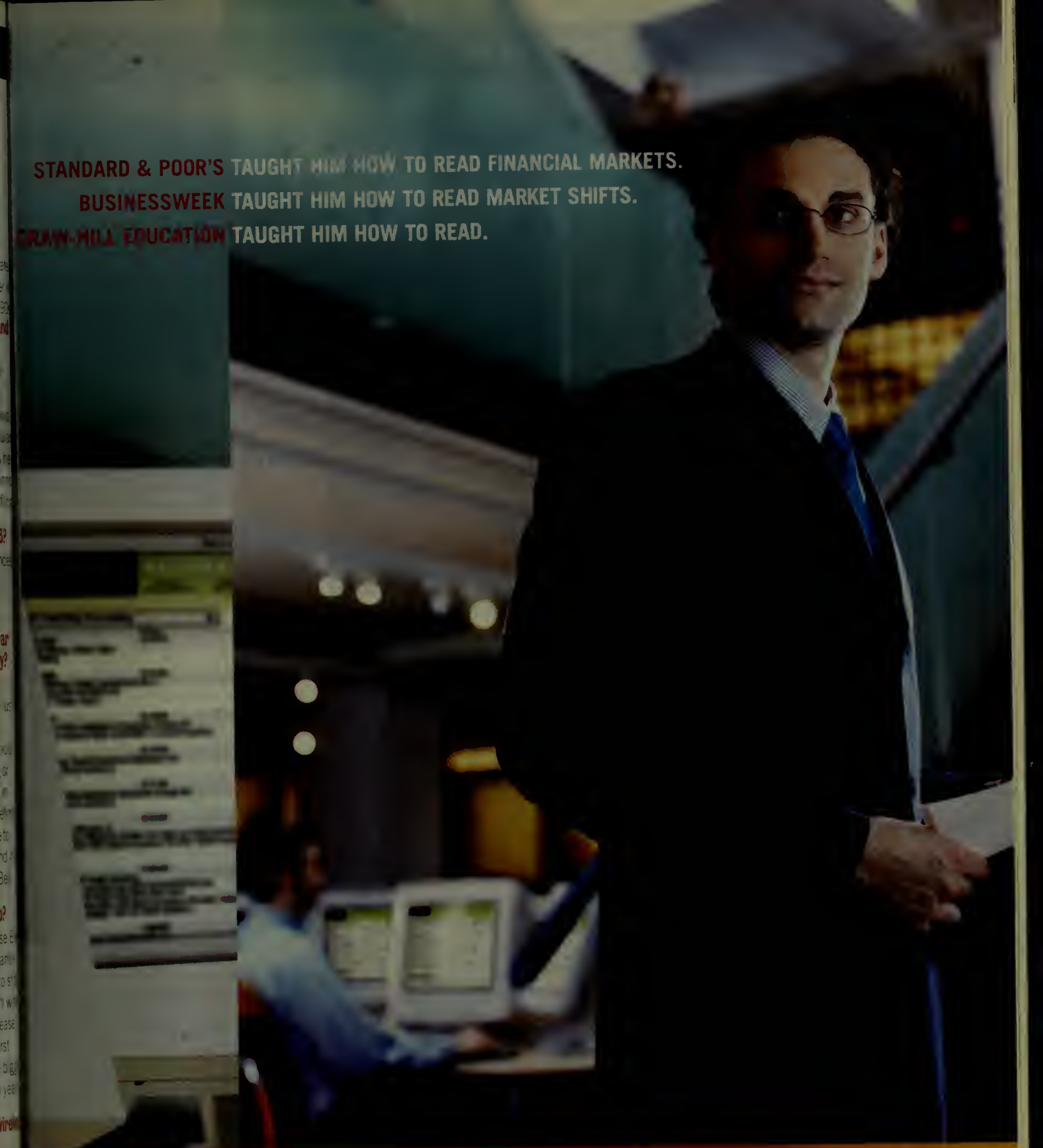
A: AT&T has to merge because Bell are getting into its long-distance business. The FCC is going to stop favoring AT&T and WorldCom with deeply discounted fees to lease local Bell networks in the first quarter of 2003. It'll be the biggest regulatory change in seven years.

Q: What's the outlook for wireless?

A: There needs to be further consolidation, with Nextel Communications Inc. and T-Mobile USA International likely to find partners.

Q: And for equipment makers?

A: Lucent Technologies Inc. and Nortel Networks Ltd. are going to be survivors. But optical [network] providers such as Ciena Corp. will have a tough road. There's a fiber glu



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Unpolished Financial Gems

You'll have to look beyond Wall Street's scandal-spattered blue chips. **BY EMILY THORNTON**

INVESTORS SEEKING quality financial stocks at reasonable prices are going to have to look beyond Wall Street's scandal-tainted, struggling blue chips. After a fourth quarter runup, many now look expensive. The best hope of making real money is betting on lower-profile companies. Some have made great strides, thanks to astute managers, but the stocks still sell at deep discounts. "When you've had this robust a market move, you need to look for unpolished gems," says Guy Moszkowski, a financial-services analyst at Citigroup's Salomon Smith Barney.

Moszkowski likes companies that have strengthened their business lines despite the downturn. For example, Pittsburgh's **Federated Investors Inc.** diversified into equity funds, giving it greater exposure to an eventual market recovery. But few investors seem to have

noticed. The company's shares aren't much above their 52-week low and trade at 14 times estimated 2003 earnings—vs. 16 times for most asset-managers. Merrill Lynch & Co. forecasts the stock could jump 41%, to reach \$36, in the next 12 months.

A regional bank flying below most investors' radar is **Wachovia Corp.** in Charlotte, N.C., which operates mainly in the Southeast. When it merged with First Union Corp. in 2001, investors initially panned the deal as the marriage of two small fry that created a feeble giant. But the linkup increased the bank's client roster, and now restructuring costs are behind it. Some pros believe the bank is almost through its growing pains. Its shares are trading at 12 times the consensus estimate for next year's earnings. Most retail banks trade at 15. "The price hasn't moved at all," says Alan F. Morel, manager of Senbanc Fund, owned by Pittsburgh's PNC Fi-

nancial Services Group. He believes Wachovia's \$35 stock is worth \$68.

Philadelphia's **Sovereign Bancorp.**, savings and loan that is aggressively building up a book of business loans, another makeover story. "If they continue to do that, the market should afford them a higher multiple" than present 10 times estimated 2003 earnings, says Jeff Diamond, manager Franklin Mutual Financial Service Fund. If it becomes more of a commercial bank, its present \$14 stock price could reach the low 20s, he says.

If there's an exception to the avo blue-chip-banks rule, it's **Citigroup**. Investors such as Anton V. Schutz, portfolio manager at Burnham Financial Services Fund, have been buying Cit shares, which are down 27% from the 52-week peak. Although the bank is the subject of investigations for everything from making misleading stock recommendations to helping Enron hide losses, it has consistently made money. Having proved its ability to expand revenues through this recession, Cit "looks pretty darn cheap to me," says Tom Goggins, manager of the JPMorgan Hancock Financial Industries Fund.

Not so elsewhere on Wall Street. **JPMorgan Chase & Co.**'s stock has jumped 53% from its low in October, yet more managers suspect more nasty surprises lurk in its credit-derivative and venture capital portfolios. Once that cloud lifts, the stock could be a bargain if it falls below \$20. "I will become interested again when they've had a clean quarter without special charges," says Schutz.

News from many financial outfits may get worse before it gets better. But there are still gems to be found.

Cashing in on Financials

COMPANY/SYMBOL	PRICE*	PE RATIO*
CITIGROUP C	36.00	11
Despite scandals and an economic slowdown, nothing stops this group		
FEDERATED INV. FII	25.48	14
The asset manager trades at a discount		
SOVEREIGN SOV	13.77	10
The makeover into a commercial bank will bring a higher premium, if it's successful		
WACHOVIA WB	35.39	12
Its poorly received 2001 merger with First Union is looking better		

*Dec. 13 **Based on forecast earnings for fiscal 2003
Data: Bloomberg Financial Markets, *BusinessWeek*, 1/2

Drug Stocks on The Mend

Healthy pipelines and fewer patent expirations spell relief.

CAROL MARIE CROPPER

AFTER THE GIANT headache that was 2002, drug stocks should perk up in 2003. Pharmaceutical profits and share prices languished this year as a spate of big-name drugs lost patent protection and fell prey to generic competition. But in 2003, comparisons of earnings and sales growth will become easier, as patent expirations will let up. Meanwhile, new products are in the pipeline. So this could be your chance to scoop up shares of large, high-quality pharmaceutical companies that were much cheaper a couple of years ago, says J.C.

Waller, co-manager for Icon Healthcare Fund.

Pfizer Inc. is one. It traded at a hefty trailing price-to-earnings ratio of 54 in June, 2000, as it acquired rival drug-maker Warner-Lambert Co. Waller calls it a bargain at 17, based on earnings projections for fiscal 2003. The maker of such hot drugs as Viagra and Lipitor (to lower cholesterol) will reap efficiencies through its planned acquisition of Pharmacia, adds Stephen M. Scala, a pharmaceutical analyst at SG Cowen Securities Corp. Both companies excel at developing new products. Plus, they have many profitable drugs with years left on their patents.

Medicis Pharmaceutical Corp.

is another Waller pick. The stock trades at 19 times next year's earnings, and Waller predicts 16% average annualized earnings growth over the next three years. Waller says the \$212.8 billion company, which makes a variety of treatments for skin problems, has plenty of cash—\$589 million as of Sept. 30—and does a good job of controlling costs, with a 39.7% operating profit margin.

Samuel Isaly, who manages the Eaton Vance Worldwide Health Sciences Fund, likes **Novartis**, the Swiss maker of Neoral/Sandimmun, a drug to prevent transplant rejection, and Diovan/Co-Diovan, for high blood pressure. Despite a modest p-e of 18 for this stock, the compa-

Feeling Better, Thank You

COMPANY/SYMBOL	PRICE*	P-E RATIO**
AMGEN AMGN	\$50.32	29
Bargain price for world's largest biotech drug producer		
ELI LILLY LLY	64.47	24
Could eventually surpass Pfizer as the industry's fastest grower		
MEDICIS PHARMACEUTICAL MRX	49.02	19
Outstanding growth potential at a bargain price		
NOVARTIS NVS	36.35	18
Promising drug pipeline, modest valuation		
PFIZER PFE	30.50	17
Acquisition of Pharmacia should boost this already strong company		
SERONO SRA	13.46	21
New multiple sclerosis drug will add to profit growth		

*Dec. 13 **Based on forecast earnings for fiscal 2003
Data: Bloomberg Financial Markets, I/B/E/S, BusinessWeek

ny—whose American Depositary Receipts trade on the New York Stock Exchange—should see earnings and sales growth of 10% to 12%, he says.

Serono, another Swiss company with ADRs, is a pricier Isaly choice, with a p-e of 21. But Isaly points to popular products, such as Gonaf-F, a fertility drug, and Rebif, a treatment for multiple sclerosis, and predicts that Serono will see average annual profit growth of 15% to 20% in the next five years.

Then there's **Amgen Inc.**, the big drug/biotech company Isaly calls "the stock for the decade." Amgen trades at a p-e level of 29, down from 77 in July, 2000. For this, you get blockbuster drugs Epogen (which stimulates production of red blood cells) and Neupogen (white blood cells), plus a pipeline set to deliver other such products soon.

Scala adds **Eli Lilly & Co.** to the shopping list. Selling at a 24 p-e, Lilly hasn't been beaten down as much as other drug stocks. Its pipeline is rich, with as many as five new products expected to hit the market in 2003—including Cialis, a Viagra competitor.

Technological advances, along with America's aging population and rising incomes, are important for sparking sales. The coming year should bring a strong marquee of new drugs to boost profits and bring out the stock-buying public.



Q&A

BIG YEAR FOR BIG PHARMA



Drug stocks in the Standard & Poor's 500-pharmaceutical index are off almost 20% from the beginning of 2002. But **Stephen M. Scala**, a pharmaceutical analyst with

SG Cowen Securities Corp., thinks the industry will bounce back soon. Scala talked with Personal Finance Editor Carol Marie Cropper about the reasons:

Q: Why do you see 2003 as a good year for drug stocks?

A: First, sales and earnings for the industry overall should accelerate in 2003 vs. 2002. The comparisons are easy because 2002 was quite weak.

Q: Of course, the market in general was down.

A: That really had nothing to do with it. It was predominantly because of major patent expirations, which clipped profits and sales for a number of companies: Bristol-Myers Squibb, Eli Lilly, and GlaxoSmithKline.

Q: What about 2003?

A: Six to eight new products are rolling out in 2003. You have Abilify from Bristol-Myers Squibb for schizophrenia. There's Zetia, a cholesterol-reduction drug, from Merck and Schering-Plough. And from Lilly, you have Strattera for attention deficit hyperactivity disorder.

Q: So, that's a second reason for your optimism. Anything else?

A: We now have a new Food & Drug Administration commissioner, and the FDA has picked up its new drug approval rate.

Q: Would congressional passage of Medicare prescription coverage for seniors be a drag on this industry, since there would be government pressure to hold prices down?

A: We believe it would be a positive for the industry....They'll sell more drugs, and the marketplace—not the government—will dictate the price.



If It's Dividends You Want

REITs still promise decent payouts, even though their prices are coming under pressure. **BY MICHAEL ARNDT**

REAL ESTATE investment trusts have been a rare haven for investors during the bear market, especially for those seeking a dependable income stream. After double-digit gains in 2000 and 2001, the industry closed out 2002 with a 2.4% total return, vs. a decline of 22.5% for the Standard & Poor's 500-stock index.

But fundamentals are turning against much of the industry. Analysts fear slumping earnings will drag down REIT share prices, offsetting at least some of their rich dividend payouts, which currently average 7.25%. Some analysts are warning investors to steer clear of office, apartment, health-care, and lodging REITs till 2004. David Schulman of Lehman Brothers Inc. advises clients to "underweight" 16 of the 31 REITs he tracks. "Personally," he says, "I've been buying tech stocks."

Maybe Schulman doesn't care about dividend yield, but many investors do, and many REITs still look good on that

count—especially mall operators. Analyst Gregory J. Whyte of Morgan Stanley spotlights Chicago-based **General Growth Properties Inc.**, which reported 52% jump in third-quarter net income on a 31% rise in revenues. Moreov

Rent Riches

COMPANY/SYMBOL	PRICE*	YIELD
AMB PROP. AMB	\$28.00	5.9%
Well-positioned for a rebound in the industrial sector		
BOSTON PROP. BXP	36.45	6.7
An island of stability among office REITs		
GENERAL GROWTH PROP. GGP	50.35	5.7
Fast-growing mall owner with a rising dividend		
MILLS MLS	29.55	7.4
Largest operator of regional megamalls		
SIMON PROP. GROUP SPG	33.55	6.6
Diverse holdings, with no one tenant above 5% of total rent		

*Dec. 13

Data: Bloomberg Financial Markets, *Business Week*

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its vacancy rate held steady at 11%, while rents on lease renewals climbed 16.5%. It recently boosted its dividend by 11% and vows to maintain it through 2003's third quarter. As for others in this category, Steve Sakwa of Merrill Lynch & Co. also likes **Mills Corp.**, while Lee Schalop of Banc of America Securities picks **Simon Property Group Inc.**

The industrial sector could also surprise investors. The rationale: Demand for warehouses and factories should revive quickly as the economy grows. At the top of analysts' lists is **AMB Property Corp.**, a San Francisco REIT big in cargo facilities at airports and seaports.

If you still want an office REIT, Whyte suggests **Boston Properties Inc.**

Admittedly, its portfolio includes two of the weakest markets today: San Francisco and hometown Boston. But Whyte says less than 5% of its leases come up for renewal in 2003. Worst case, he figures the REIT will return its 6.7% dividend. Not a home run by any means. But it would surely be a single or double in any market.

ENERGY

Power from Energy

Some oil stocks are set to pump back up in 2003.

BY CHRISTOPHER PALMERI

CRUDE-OIL PRICES have climbed 50% in the past year as the specter of war with Iraq and political unrest in Venezuela continues to haunt the market. Yet oil-company shares have gone the other way: Evidently the market doesn't seem to think prices of \$30 a barrel are sustainable. As a result, the average international oil-company stock has fallen about 11% in 2002.

Those diverging trends—oil prices up, stocks down—create an opportunity to pick up quality issues at bargain prices. L. Bruce Lanni, an energy analyst at A.G. Edwards & Sons Inc., thinks oil prices won't drop much—to an average of \$25 a barrel next year—because of strengthening world economies and production restraint on the part of OPEC. If that's the case, energy-company stocks could do quite well in 2003.

Lanni's top pick is **Royal Dutch Petroleum**, whose shares have dropped 11% this year. Much of that decline is based on an event beyond the company's control: Royal Dutch was removed from the



Oil Patch Plays for the New Year

COMPANY/SYMBOL	PRICE*	P-E RATIO**	COMMENTS
DOMINION RESOURCES D	\$54.00	11	Electrical utility with improving balance sheet—and a 4.9% yield
ROYAL DUTCH RD	42.60	15	Stock depressed, but outlook good for better profits
PEABODY ENERGY BTU	28.35	17	Stands to gain from a rising demand for coal
SMITH INT'L SII	34.03	25	Increased drilling for natural gas should boost profits
UNOCAL UCL	31.36	18	Production picking up, and Far East properties are promising

*Dec 13

**Based on forecast earnings for fiscal 2003

Data: Bloomberg Financial Markets, I/B/E/S, BusinessWeek

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Spectrum Income ★★★★★
GNMA ★★★★★

These funds were rated among the following categories for the overall rating and the 3-, 5-, and (if applicable) 10-year periods: Capital Appreciation Fund, 686, 686, 517, and 129 domestic hybrid funds; Growth Stock Fund, 773, 773, 507, and 160 large growth funds; Equity Income Fund, 632, 632, 471, and 159 large value funds; Mid-Cap Value Fund, 194, 194, and 128 mid-cap value funds; Spectrum Income Fund, 157, 157, 112, and 29 multisector bond funds; GNMA Fund, 274, 274, 240, and 102 intermediate government funds.

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Standard & Poor's 500-stock index in July—along with all other companies headquartered outside the U.S. That change forced index funds to dump the stock. Royal Dutch has plenty going for it, says Lanni: cost-cutting and the divestiture of lower-returning assets. He figures that earnings will climb 15% next year, to \$3.05 a share.

Another familiar name going cheap is **Unocal Corp.**, a Los Angeles oil-and-gas producer. At \$31.36, the stock is down from nearly \$40 in April. J.P. Morgan Chase & Co. oil analyst Shannon Nome—whose firm has done investment banking for Unocal—thinks the sell-off is overdone. She says Unocal is trading at a 20% discount to its peers, based on her projection of the 2003 cash flow. Nome figures Unocal's production of oil and gasoline will climb about 3% annually in the coming three years. "Virtually every other analyst is negative on Unocal," Nome says. "But the company's lineup of projects still looks good."

In 2002, stocks of oil-field suppliers held up better than those of producers, but Banc of America Securities analyst Jim Wicklund still sees opportunities. In particular, he likes **Smith International**, which provides drill bits and fluids. Wicklund notes that several U.S. natural-gas producers that cut drilling in 2002 will step it up in the new year, boosting the profits of companies like Smith.

In the battered power industry, **Dominion Resources Inc.** in Richmond, Va., looks poised to prosper. The company supplies electricity and gas to 3.8 million customers in five states. To strengthen its finances, Dominion has sold stock and reduced capital expenditures. It has no major international or energy trading operations, sources of trouble for others. Dominion also has sizable oil and gas businesses that should benefit if gas prices remain strong.

The electricity market still shock you? Frederick Sturm, portfolio manager of the \$30 million Ivy Global Natural Resources fund, suggests **Peabody Energy**, the world's largest coal producer. He sees earnings up 50% next year, to \$1.70 a share, thanks to rising coal prices and higher demand for electricity brought on by a strengthening economy.

O.K., coal doesn't sound like an exciting investment. But it can be a solid one. Even in the 21st century, half the electricity generated in the U.S. comes from coal. ■

The Start of Something Big?

Some investors see 2003 as the year improving ad sales propel the media biz. **BY RONALD GROVER**



EVERYONE LOVES A mystery. In 2003, media investors will have one of their own: Will the nascent advertising recovery, which lifted TV networks in 2002, spread to the rest of media? The results look promising, with U.S. ad sales projected to rise 5.3% in 2003, more than double the prior year's 2.6% hike.

Investors, who returned to media stocks in mid-2002 with buys on **Viacom** and **News Corp.**, are now eyeing such flattened stocks as **AOL Time Warner**. Some look favorably even on cable stocks like **Comcast** and **Cox Communications**, whose industry has been shaken by debt concerns and the fallout from criminal charges at Adelphia Communications.

Some players are betting the advertising revival will continue. Mark G. Greenberg, portfolio manager at Denver-based **INVESCO Leisure Fund**, recently added to his stake in ad giant **Omnicom Group**, which owns three of

Hot Buys in Media

COMPANY/SYMBOL	PRICE*	P-E RATIO
COX COX	\$29.45	10
One of the best cable operators. Free cash flow will grow thanks to system upgrades		
FOX FOX	29.86	23
TV holdings stand to gain from uptick in advertising, and cable channels Fox News, Fox Sports, and FX are red-hot		
LIBERTY MEDIA L	9.28	NA
Media mogul John Malone's vehicle is well-positioned to benefit from the industry's troubles		
UNIVISION UVN	25.79	53
Hot Hispanic advertising market lifts owner of TV stations		
VIACOM VIA.B	41.25	2
New management at TV stations and rating king CBS will help generate free cash flow		

*Dec. 13 **Based on forecast earnings for fiscal 2003
Data: Bloomberg Financial Markets, BW, I/B/E/S

Check before investing

- ☒ 44 million*¹ subscribers
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- ☒ Solid revenue growth for the past decade, and further growth expected for the future.
- ☒ More than a 58% share of Japan's mobile communications market*²
- ☒ 35 million users of NTT DoCoMo's wireless internet service — i-mode™



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Source: NTT DoCoMo Corporate Website. As of October 2002. Actual screen may differ from that shown above.
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i-mode is a trademark or registered trademark of NTT DoCoMo, Inc. in Japan and other countries.

*1 Includes subscribers for FOMA (3G), PHS, pager and other services.
*2 Source: Telecommunications Carriers Association (POC) (2G + FOMA (3G)).

the world's 10 largest agencies. Greenberg figures that, with half Omnicom's business overseas, it has plenty of room to grow as weaker foreign ad markets begin to pick up later in the year.

J.P. Morgan Chase & Co. analyst Spencer Wang believes embattled AOL Time Warner has the biggest upside. Wang likes its non-Internet assets, including its cable channels, magazine unit, and the movie studio that produced the *Harry Potter* and *Lord of the Rings* blockbusters. He figures the company will generate a robust \$4 billion in free cash flow in 2003 and that its non-Internet business is worth more than the company's \$14 stock price. He projects \$20 within a year.

John Malone's Liberty Media, which

holds everything from AOL to News Corp. and the Discovery Channel, is ideally situated to take advantage of a media comeback, says S. Basu Mullick, a portfolio manager for the Neuberger Berman Partners Fund. Mullick figures Liberty, trading below \$10 for months, is worth at least \$14 a share.

One of the media world's biggest potential deal—a bid by Rupert Murdoch's News Corp. to buy Hughes Electronics' DirecTV satellite service—has buyers on both sides of the transaction. Mullick owns Hughes Electronics. Ajay Mehra, a portfolio manager with Columbia Management Group, likes News Corp.'s fundamentals, including its fast-growing stable of cable channels. A deal to buy Hughes would give Murdoch more op-

portunity to distribute his worldwide collection of sports, news, and entertainment programs, he says.

Improving fundamentals make cable a better buy, says Larry Haverty Jr., vice president of State Street Research & Management Co., which holds Comcast and Cox. Both have major debt after laying superfaster fiber-optic wires to battle satellite TV with new interactive services, and Comcast still must digest its \$30 billion acquisition of AT&T's cable systems. But Haverty likes both companies' cost-conscious management and thinks the bungled EchoStar-Direct merger has hobbled cable's biggest rivals. Whether the cable companies can come back, however, is another mystery media investors want to see resolved.

CYCLICALS

Pendulum Plays

Is the upswing in sight? Try these. BY PALLAVI GOGOI



move higher during a recovery—and some pros are especially bullish on chemical stocks now. Morgan Stanley & Co. analyst Leslie C. Ravitz recommends both **DuPont** and **Dow Chemical Co.** (He owns neither.) DuPont's stock, a classic blue chip with a conservative balance sheet, at \$42.56 sports a generous 3.3% yield. He projects an 11% gain in net income in 2003. Ravitz is even more bullish on Dow, where he expects a 21% gain. He says the company will benefit from low inventories, which could lead to higher prices for its wares. And there's high hope for new management. On Dec. 13, the

board replaced CEO Michael Parker with William Stavropoulos who will be under the gun to improve returns.

Take a look, too, at **Caterpillar Inc.**, the world's leading manufacturer of heavy equipment. Since Cat has been sharply reducing costs in the past two years, any uptick in business should drop to the bottom line, says Dan Bandi, portfolio manager for the Armada Large Cap Value Fund. At \$44.60, Caterpillar sells for 18 times 2003 earnings, and Bandi estimates the stock could be

worth \$65 in the next 12 months.

Another cyclical play is **Alcoa**, the world's No. 1 aluminum producer. Wendell L. Perkins of Johnson Asset Management in Racine, Wis., likes Alcoa because he thinks a global recovery will push aluminum prices higher. Perkins is looking for \$30 a share, a 30% gain.

One warning: If the economic outlook suddenly turns bleak, be ready to sell. They're lousy buy-and-hold investments.

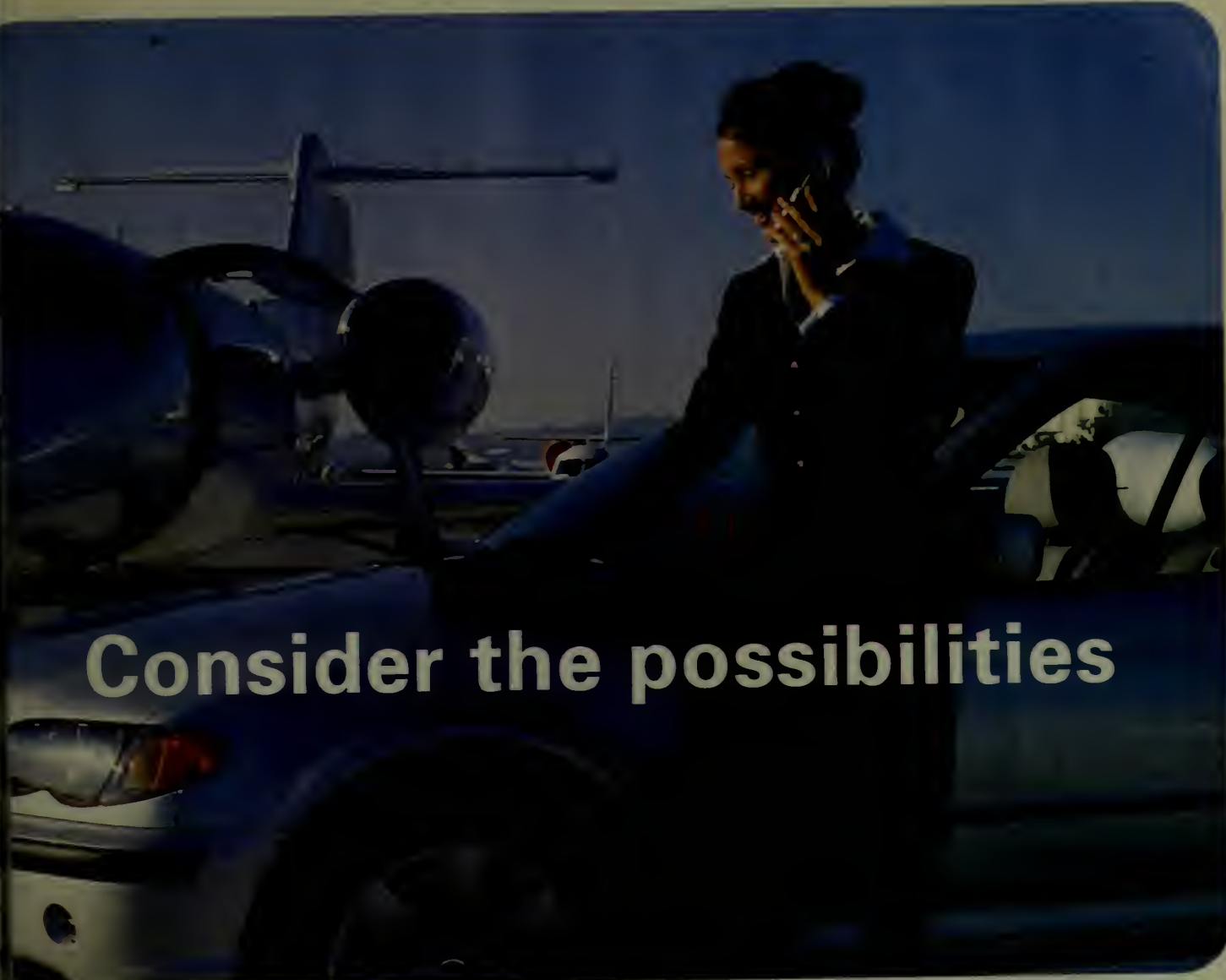
Riding the Cyclical

COMPANY/SYMBOL	PRICE*	P-E RATIO**
ALCOA AA	\$23.03	15
Good play if, as expected, aluminum prices turn up in '03		
CATERPILLAR CAT	44.60	18
Sharp cost reductions should lead to higher profits		
DOW CHEM. DOW	29.05	21
Inventories are low, and profit margins could go higher		
DUPONT DD	42.56	19
Strong balance sheet; usually hits earnings targets		

*Dec. 13 **Based on forecast earnings for fiscal 2003
Data: Bloomberg Financial Markets, V/B/E/S, BusinessWeek

IF YOUR CRYSTAL BALL is showing a recovery in 2003, invest in cyclical stocks. As the name implies, these companies have profits and share prices that track the economy's ups and downs. And they often look their worst—their price-earnings ratios are highest—right before an upturn. Then p-e's come down as the profits kick in.

Industrial cyclical stocks such as chemical and paper stocks are usually the first to



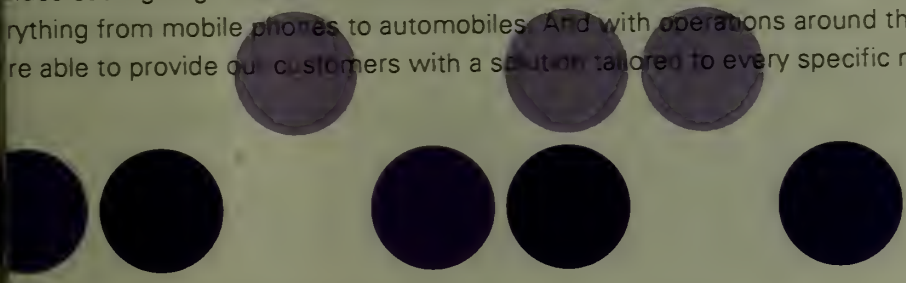
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In the *on demand* era, servers will need to have the ability to repair crashes before
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imagined. This is the kind of autonomic, *on demand* technology IBM is building
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Casinos Are On a Roll

With a slew of new gaming licenses likely, the industry is set to expand. **BY CHRISTOPHER PALMERI**

WITH STATE finances in the red and a slew of new pro-gambling governors in office, 2003 could turn

out to be a big year for gaming industry expansion. Slot machines are likely to pop up at racetracks in Pennsylvania, New York, Massachusetts, and Maryland, while Illinois and Missouri are considering issuing more casino licenses.

One company that has seized on such opportunities is **Harrah's Entertainment Inc.**, the Las Vegas-based gaming giant that operates 26 U.S. casinos. Harrah's is a favorite of Mark Greenberg, portfolio manager of the \$733 million Invesco Leisure Fund. The company's operations are well-diversified, with casinos in New Jersey, Illinois, and Mississippi as well as Nevada. It is taking advantage of Indian gaming expansion

by managing properties for tribes in California and other states. Harrah's is expected to report earnings of \$3 per share in 2002 and \$3.23 in 2003, according to Wall Street analysts. That gives it one of the better growth rates among the large casino operators.

A Harrah's rival, **Park Place Entertainment Corp.**, also looks promising. John Miller, an analyst at Ariel Capital Management Inc. in Chicago, says his firm began buying Park Place stock in October at under \$7 a share, down from the 52-week high of \$12. He thinks the stock has been unfairly hit due to a construction snag at Park Place's Caesars property in Las Vegas, where it is building a specially-designed theater for singer Céline Dion.

Once the construction is done, says Miller, Park Place could be at \$12 again.

Todd Griesbach, an analyst at Lily Wanger Asset Management, is a fan of **Station Casinos Inc.**, the leading operator of casinos catering to Las Vegas residents. Station's new properties include amenities such as movie theaters and day spas. It has another card up its sleeve: a potentially lucrative deal to run an Indian casino in Sacramento. Station is expected to earn \$1.02 a share in 2003, up from 68¢ in 2002.

Bear, Stearns & Co. gaming analyst Jason N. Ader is less interested in casino operators than he is their equipment suppliers. His top pick is **International Game Technology**, the world's largest slot machine maker. "For the casino companies, there's a lot of potential for competition," says Ader, who does not own IGT nor does his employer have a banking relationship with the company. "Slot machine makers are better positioned, because they benefit no matter who wins or loses." Ader thinks growth in new markets will allow IGT to earn \$5 a share for its fiscal year ending September, 2003, and \$5 a share by 2005. IGT, which now trades at \$73, is "a potential \$100 stock," he says.

Also supplying the casinos is **Shuffle Master Inc.**, a \$56 million-a-year maker of card-shuffling machines. Shuffle Master has some new products, such as single-deck shufflers for poker tables and proprietary card games like Let It Ride and Three Card Poker, that it leases to casinos. Griesbach thinks Shuffle Master will earn 95¢ per share in the October 2003 fiscal year, up from 77¢ in 2002.

Lots of people still consider the stock market a gamble. When you invest in casino stocks, you're betting with your house.

Smart Bets?

COMPANY/SYMBOL	PRICE*	P-E RATIO
HARRAH'S ENTERTAINMENT HET	\$37.79	12
Diversified gaming operator reaches well beyond Las Vegas		
INTERNATIONAL GAME TECH IGT	73.12	19
Slot machine manufacturer is a big winner		
PARK PLACE ENTERTAINMENT PPE	8.00	13
High hopes new management will boost undervalued play		
SHUFFLE MASTER SHFL	19.48	17
Equipment maker's new card games dealing out profits		
STATION CASINOS STN	17.58	16
Where Las Vegas locals go to gamble		

*Dec. 13 **Based on forecast earnings for fiscal 2003
Data: Bloomberg Financial Networks, BusinessWeek

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Where in the World to Invest

Europe and Asia offer a handful of sectors where modest gains may be found. **BY DAVID FAIRLAMB**

FOREIGN STOCKS have been a disaster for American investors for years. But that may change soon. Prices, particularly in Europe, are so low that bargains are easy to find. "The [European] markets have priced in deflation and the return to a 1930s-style depression," says Haydn Davies of London's Barclays Global Investors Ltd. "But that's not going to happen."

Many high-quality European companies are going for a song. Steve M. Russell, a pan-European strategist at HSBC Securities Inc. in London, says traditional stocks such as pharmaceuticals, support services, and utilities are the best place to prospect. "It's now time to

look beyond defensive, safe investing," he says. Companies that are cutting costs, focusing on core businesses, and fixing strategic mistakes look attractive—among them German utility E.ON, and its French counterpart, Suez, which have gained market share thanks to deregulation. Shares of drugmakers such as Switzerland's Novartis, Germany's Schering, and Britain's GlaxoSmithKline also are expected to rise. Each has important new drugs, such as Schering's hormone-replacement therapies Betsaseron and Yasmin.

And 2003 promises to be a good year for support services such as recruitment firms and temporary agencies. That may seem odd, given the sluggish economy and rising unemployment in Germany and several other countries. For years,

however, outsourcing has been growing in Britain and is fast spreading across the Continent. Besides many companies that have laid off staff are expected to start hiring part-time or temporary help later in 2002. That bodes well for Switzerland's Adecco, the world's biggest recruitment agency, and its Dutch rival, Randstad Holding.

Look for European insurers to regain some of the luster in 2003, says Udo Rosendahl, who heads European equities at DWS Investments, a large German mutual-fund manager.

They took a beating in 2002, when the bear market ravaged investment portfolios and their profits were hit by huge claims from floods in Central Europe and the attacks on the U.S. in September, 2001. Since then, nonlife premiums have edged up, meaning that companies such as Italy's Assicurazioni Generali, one of Europe's most conservative underwriters, and Germany's giant Allianz should be in a good position to boost earnings.

EASIER AFTER EASING?

Companies whose shares usually rise when interest rates fall should also outperform the market in 2003. On December 5, the European Central Bank cut its key rate by 50 basis points, to 2.75%, and is expected to trim it by another 50 basis points in the next three months. That should give the Continental real-estate market a boost and encourage consumer spending. Stocks that will benefit, analysts say, include German real-estate company wcm and Belgian retailer Delhaize Group. But many bank stocks, which normally do well when rates decline, will continue to languish because of slow economic growth and the rising tide of corporate insolvency.

In Japan, bank stocks are also largely a no-go zone. With bears ruling the stock market and with the economy heading south, the best bets are a handful of multinational companies that a

ally competitive with strong balance sheets. HSBC consumer-electronics analyst Hideki Watanabe likes **Matita Electric Industrial Co.** "for its restructuring; its highly competitive DVD players, video cameras, and other products; and its leads in developing business in China." HSBC auto analyst Christopher Richter likes both **Honda Motor Co.** and **Nissan Motor Co.**, thanks to risk sales in the U.S. He expects U.S. market share of Japanese auto makers to grow from 27.4% to 32% in the next few years. Elsewhere in Asia, **Samsung Elec-**

Vincent Strauss, chief investment officer for Paris-based Comgest, has been loading up on Esprit shares because of its growing clout in Western Europe. Esprit's price-earnings ratio of 18, based on 2002 earnings, is half that of Swedish clothing retailer **H&M Hennes & Mauritz**, for example.

SIMPLE PLEASURES

Two stocks that leverage China's fast growth catch Strauss's eye: Hong Kong-listed **Zhejiang Expressway Co.**, a toll-road operator that benefits from the surge in trade-related transport around Shanghai, and **Beijing Datang Power Generation Co.**, the largest independent power producer in northern China. "We like

boring companies that make good products," he says.

At the end of the day, though, strategists agree that 2003 is unlikely to be a bumper year. That's why there won't be a rush of foreign money into European and Asian stocks. "There is no reason for euphoria," says Jens Wilhelm, manager of Union Investment Privatfonds, part of Frankfurt's Union Investment, speaking of Europe. "But in the coming year, we do expect moderate growth in profits." So investors may not get the big market recovery they're looking for in 2003, but after several bad years, it may be time to take another look overseas.

With **Brian Bremner in Tokyo**, **Fredrik Balfour in Hong Kong**, and **Moon Ihwan in Seoul**

ny quality stocks are going for a song. Additional industries such as drugs and utilities are the best place to start

cs Co., the world's largest memory-maker and the third-largest mobile phone maker, is expected to remain in Korea's star in 2003. That's after a 27% jump in its stock through 2002—while the benchmark Kospi index rose just 2%. Analysts are predicting a net profit rise of about 10% in 2003, from \$6.2 billion in 2002, which should keep the stock moving up.

In Hong Kong, **Ajay Kapur**, head of Asia-Pacific regional strategy research at **Simon Smith Barney**, likes **Swire Pacific Ltd.**, the property and retail conglomerate that is also the largest shareholder in **Cathay Pacific Airways Ltd.** He says Swire's stock is trading at just 0.7 times book value, and has an 8% return on equity. Another Hong Kong favorite is retailer **Esprit Holdings Ltd.**

Q&A

CONTINENTAL DRIFT



Investors have piled out of European stocks for three years, but **Udo Rosendahl**, head of European equities at DWS, Germany's largest mutual-fund manager, believes

they'll find reason to return in 2003. He recently spoke with European Economics Correspondent David Fairclimb in Frankfurt.

Q: Why will 2003 be any better for investors in European stocks?

A: Valuations have fallen to very low levels. They look very cheap compared with bonds. Growth may not be terrific in 2003, but by focusing on companies with good bottom-line growth and sustainable profits, investors can make reasonable returns. It won't be an easy year, but it will be better than 2002.

Q: Will good corporate governance be an investment theme in 2003?

A: After the scandals of the past year, investors are looking at companies' corporate governance practices. They want clear codes and guidelines. Companies such as **Nokia** and **Siemens**, which take corporate governance seriously, will make attractive investments.

Q: What are the risks ahead?

A: A war in the Middle East would unsettle the market, especially if oil prices rise strongly. The uncertain political situation in Germany is a concern. If U.S. consumers draw in their horns, the global economy will slow, which would hurt many European companies.

Q: Do you expect a strong capital inflow into Europe from the U.S.?

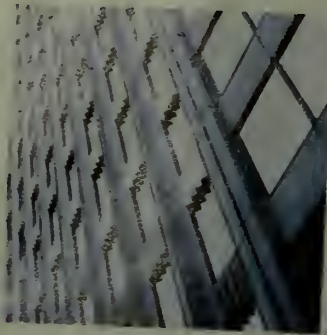
A: We don't see a huge capital inflow to Europe this year. The average U.S. investor will continue to buy domestic equities before diversifying. But the strengthening euro should make European stocks more attractive to foreigners.

Prospecting for Value Abroad

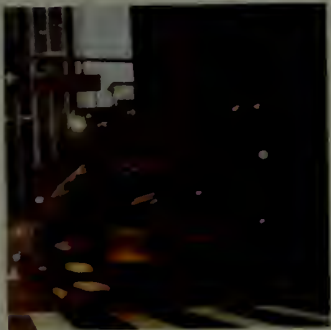
COMPANY/SYMBOL	PRICE*	P-E RATIO**	COMMENTS
LIANZ	\$10.37	13	The German insurer should rebound after it fixes the problems at its Dresdner Bank
ION	43.32	11	After taking hits from bad investments in the U.S. and Britain, this German utility is now on the mend
IAIO	36.75	14	The British pharmaceutical giant's sales and cash flow should improve as the economy perks up
ONDA	18.30	10***	Boosting its presence in the midsize SUV market in the U.S. should boost its share price
SSAN	15.90	9***	The Japanese carmaker's U.S. market share should rise from 4.4% to 6% over the next three years
OVARTIS	36.35	20	A healthy earnings outlook may make the Swiss drug outfit a good buy after its stock slumped in 2002

*Based on forecast earnings for fiscal 2003
Data: Bloomberg Financial Markets BusinessWeek 1/31/03

***fiscal year ends Mar. 31



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When you let other people into your lane

When you sing to the radio

When you have a backup route

When you use the time to prepare for work

When you use the time to forget about work

When you feel part of something larger

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Brainwork From the Experts

Four Wall Street aces on what they like—and why.

WHAT DO THE pros say? To find out, we gathered four veteran Wall Street stock-pickers to discuss the outlook for the markets and their favorite stocks.

Their bottom line: Select your investments carefully, and you can make money. Jeffrey M. Applegate, an independent strategist most recently with Lehman Brothers Inc., provided insights on growth stocks. Joan E. Lappin, president of Gramercy Capital Management Corp., with 38 years of experience analyzing and buying stocks, delivered a set of unconventional names capable of big moves. Tobias M. Levkovich, strategist at Salomon Smith Barney, offered a diverse set of picks in his quest for growth at a good price. David J. Winters, a "deep value" portfolio manager running \$21 billion at

and we're due for better. The risk now is in not owning stocks.

LAPPIN: I'm bullish, though I can't guess the S&P. Stocks look oversold. We're about to get an economic policy from Washington for the first time in two years. That can be only a plus.

WINTERS: I dissent. It's going to be a difficult environment for stock investors. Valuations and price-earnings ratios are still high. Don't count on the market to move up. To make money, you've got to select the right names. We're keeping about 30% of our domestic portfolios in cash while we search for gems in this mess.

APPLEGATE: I think the right mix is 10% cash, 10% bonds, and 80% stocks.

■ **BW:** What about bonds? They've beaten stocks for three years now.

LEVKOVICH: Bond investors will hurt. Ten-year Treasuries, now around 4%, will climb to 5% by the end of 2003. Some people think if rates go up, stocks will fall, too. But that's not true when you find stocks with good earnings growth at good prices.

LAPPIN: The bond gains are over. Next we will see the

sad sight of people chasing past performance and going into bonds after losing their shirts in stocks. If 10-year bonds go to 5% yields, people will lose 25% of their capital. Scary!

■ **BW:** Jeff, why are you so bullish on stocks?

APPLEGATE: The real Fed funds rate is now below zero, which should be very good for the profits recovery. Core inflation is close to 2%. Ten-year bonds yield little, and investors are going to demand less of a premium for the risk they are taking. The bottom for stocks here and abroad was Oct. 9.

■ **BW:** What could go wrong with the bull story, besides terrorism?

LEVKOVICH: As interest rates rise, you might not get offsetting earnings

growth. Government policies are going to be a bigger variable in driving business and investment results—policy on taxation, energy, health care, defense spending. Your risk is that politicians will be shortsighted and do the wrong things.

WINTERS: Not to sound like a bull, but a possible good surprise would be if

THE G

“Valuations and p-e ratios are still high. Don't count on the market to move up.”

David Winters



A bear and three bulls point to potential profits and warn you away from possible pitfalls

Franklin Mutual Advisers LLC, pointed to safe bets, often abroad. They traded views in December as the Standard & Poor's 500-stock index hovered just over 900 and the Dow Jones industrial average around 8,700. *BusinessWeek* Associate Editor David Henry moderated the discussion.

■ **BW:** For stocks in 2003, who among you are the bulls and the bears?

LEVKOVICH: I'm tactically bullish, looking for 1,075 on the S&P at the end of 2003 and a long-term, five-year annual trend return of 7%. That's up an appealing 17% from here, but I expect a lot of volatility, as much as 20% up and down along the way.

APPLEGATE: I'm bullish as well, with a price target of 1,100 on the S&P. We've had the worst bear market in 70 years,

...n't have a war and then oil prices
...line.

BW: Or maybe we have a quick war
...t opens up Iraqi oil production.

WINTERS: That'd be huge for consumers
...l hugely bullish for the economy.

BW: Tech stocks led the market up in
...ember. Are they the way to go?

WINTERS: No. Basically, everybody just
...hed back into the same old names. It
...s hope over fact.

LEVKOVICH: There's no big upturn com-
...in spending for technology. Compa-
...s are replacing things when they
...ak.

APPELEGATE: Tech stocks are high gen-
...ally. But companies are going to be
...stituting equipment for labor for a
...g time to come, so you want to
...ch for opportunities. I like Microsoft

Corp. right now. It is trading at a dis-
...count to its peers, which is unusual.

LEVKOVICH: Microsoft is a company that
...investors should want to see pay a div-
...idend. It recently revealed that it makes
...85% margins from Windows and loses
...money everywhere else. Do you really
...want them to be in charge of keeping
...\$30 billion in cash? Don't you want them
...to pass out some of it?

■ **BW:** Should people look for stocks that
...may pay more dividends?

LEVKOVICH: Yes. Long-term stock re-
...turns have been 10.2% compounded an-
...nually, and 4.7 percentage points of that
...was dividends. Investors increasingly
...want dividends after these years of
...bruising market losses. Home Depot
...Inc., one of the names I like, raised its
...dividend 20% recently. Other companies
...will follow.

WINTERS: Dividends pay you to wait for
...the day stocks go up. One of my picks is
...BP PLC, which yields nearly 4%. Money
...market funds give you only 1%. It's a
...well-run company that trades at a dis-
...count to asset value. I can't predict the
...price of oil, but this one doesn't have a
...lot of risk.

LAPPIN: I've got two oil-field services
...favorites, GlobalSantaFe Corp. and
...Tesco Corp., a small Canadian company.
...Global has an excellent fleet of offshore
...rigs. The business is coming out of a
...cyclical bottom. Plus, drilling had been
...postponed by the mergers of the major
...oil companies. Tesco is offering the first
...true innovation in drilling since Howard
...Hughes's drill bits. They put in the well
...casings while drilling, reducing costs
...and time by one-third.

■ **BW:** What are the chances consumers
...will be tapped out before
...there's more strength in
...corporate profits?

APPELEGATE: Consumers
...should be just fine.
...Household net worth and
...disposable income are
...still high, historically.

LAPPIN: If the consumer
...is O.K., why, for exam-
...ple, is Home Depot hav-
...ing a problem?

LEVKOVICH: Home Depot
...stock has been severely
...punished. A lot of their
...problems have been self-
...inflicted. The issue wasn't
...consumer spending. Peo-
...ple are still redoing their
...homes. The new CEO
...came, fired a number of
...people, brought back
...temps, and messed with
...the customer-service cul-
...ture. They lost market
...share as people went to
...other stores. They are
...fixing those mistakes.

WINTERS: Isn't Home De-
...pot cannibalizing its sales
...with too many stores?

LEVKOVICH: They are still
...not in a lot of places.
...And look, you can get
...the stock at a 50% dis-
...count to what you would
...pay for the other big
...home-improvement chain,
...Lowe's.

APPELEGATE: Health-care
...stocks offer good earn-
...ings growth. Their earn-
...ings estimates are being

GUIDANCE

...e bond
...are over.
...ds go to
...elds,
...e will lose
...of their
...l."

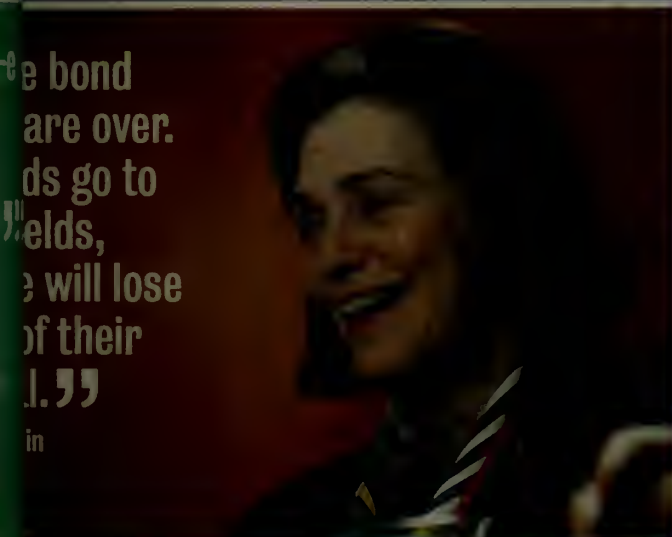
in

...e real Fed funds
...now below
...very good
...profits
...ry."

legate

“The financial sector
should benefit from
some tort reform.
Republicans want to
help.”

Tobias Levkovich



revised up. I like Pfizer Inc., despite the risk in its acquisition of Pharmacia Corp. They ought to deliver 15% earnings growth the next couple of years, which isn't in the stock price.

LEVKOVICH: I like Pfizer, too. The benefits from integrating Pharmacia are big. Plus, there is less risk from sales of generic drugs next year because fewer products are coming off patent in 2003. They have one of the best new product streams in an industry that doesn't generally have a great pipeline.

AmerisourceBergan Corp. is another good one. The stock is selling around 16 times next year's earnings. They're one of the leading distributors of drugs. They will thrive with generics or prescription drugs because they have power in their market. The government is not going to allow any incremental mergers in their industry, so it's about as consolidated as it will get.

And don't ignore the Republican sweep of Congress. You've taken out a lot of really negative aspects that have been overshadowing the drug industry. **APPLEGATE:** Political risk is way down for Coventry Health Care Inc., too. The company has high sales growth. And they grow by acquisition. The industry itself is raising prices.

LEVKOVICH: The government is behind another of my picks: aerospace contractor Lockheed Martin Corp. We're going to spend more on defense, and the war on terrorism is going to take time. I just don't see this one going away. In this economy, you select the few companies that grow faster than GDP. Investors have left this one behind.

■ **BW:** How are the pickings among financial stocks?

WINTERS: I like White Mountains Insurance Group, a property-casualty insurer. It recently bought control of some insurance assets at half of book value. The business has pricing power now, and superb management.

LEVKOVICH: A better-known insurance stock is American International Group [a banking client of Levkovich's firm]. They participate in the pricing game. The stock is down from its historical premium valuations. The sector should benefit from some tort reform. Republicans want to help. Asbestos suits are a biggie, so that black hole could close.

WINTERS: AIG is a fine company, but more expensive than I like.

APPLEGATE: I like Citigroup. It's a premier play in our recovering global securities markets. Citi's issues over ana-

lysts and investment banking are going to be settled.

LEVKOVICH: I've got Wells Fargo & Co. [a banking client of Levkovich's firm], a top regional bank. They know their business. Fear over bad debts in the banking system is misplaced. Most of the bad debts are in junk bonds.

LAPPIN: Providian Financial Corp., the credit-card company, is on my list. It's a turnaround. New management is cleaning up. Default rates are dropping. The stock went from 80 down to 2. We started fooling with it at 3. It's 6 now, and we just bought more.

■ **BW:** David, you've got an international fund. What are you finding abroad?

WINTERS: One that literally crosses borders is Canadian National Railway Co., the best-run railroad in the world. They bought Illinois Central and Wisconsin Central. It trades around a reasonably low 11 times earnings. They just actually took an asbestos hit for brake shoes on steam locomotives.

The Pros' Picks

COMPANY/SYMBOL	PRICE*	P-E RATIO**
JEFFREY M. APPLGATE		
AT&T WIRELESS AWE	\$6.41	102
CITIGROUP C	36.00	11
COVENTRY HEALTH CVH	28.90	11
MICROSOFT MSFT	52.50	24
PFIZER PFE	30.50	17
JOAN E. LAPPIN		
COMCAST CMCSA	22.84	NA
GLOBALSANTAFE GSF	25.00	19
NEXTEL NXTL	12.07	19
PROVIDIAN PVN	6.12	9
TESCO TESOF	11.10	32
TOBIAS M. LEVKOVICH		
AMERICAN INT'L AIG	59.00	15
AMERISOURCEBERGEN ABC	57.16	12
HOME DEPOT HD***	26.39	15
LOCKHEED MARTIN LMT	49.70	19
WELLS FARGO WFC	46.00	13
DAVID J. WINTERS		
BP BP	39.27	15
CANADAN NATL RAIL CNR	43.20	13
GROUPE DANONE DA	25.85	18
IMPERIAL TOBACCO ITY	32.07	12
WHITE MOUNTAINS WTM	316.22	NA

*Dec. 13

**Based on forecast earnings for fiscal 2003

***Home Depot estimate based on yearend Jan., 2004
Data: Bloomberg Financial Markets, I/B/E/S

■ **BW:** Is the asbestos trouble over? **WINTERS:** You never know with bestos. But it's a small blemish. If you are optimistic about an economic rebound, this offers lots of ways to win.

A company with a clear advantage from being overseas is Imperial Tobacco Group, based in Britain. It doesn't have the litigation problem of U.S. companies. A decision there says that if you are dumb enough to smoke, it's your problem. Imperial's managers are shrewd. They've bought a very unmanaged German tobacco company.

LEVKOVICH: Do they sell any products here?

WINTERS: Not really.

LAPPIN: But you have a company that's selling death. It doesn't matter to them they are not in the U.S.

WINTERS: People smoke voluntarily. They have for hundreds of years.

■ **BW:** Any other consumer stocks?

WINTERS: Groupe Danone. They do Dannon Yogurt and Evian water. It's a well-run company with top-line growth which is unusual. They are buying back their stock, which trades at a discount to asset value.

LEVKOVICH: I'm not convinced I want to be in any consumer staples. In a deflation seeping into them, in tobacco, diapers, soft drinks, snack foods, I don't see it now wine.

■ **BW:** Is the pricing pressure a real concern? **David Winters** can buy these financial stocks at prices even he can stomach.

LEVKOVICH: Maybe. The game is changing. It is very difficult to imagine how you differentiate water companies.

■ **BW:** Any gems in the telecom business?

APPLEGATE: AT&T Wireless Service. They've basically finished building their system footprint, so they can reduce capital expenditures. Cash flow is up 25%. The last couple of quarters they actually beat expectations. They're cheaper than Nextel Communications, which Joan likes.

LAPPIN: But AT&T Wireless hasn't been well run. Nextel uses their bandwidth effectively. They have put together a system that requires fewer cell sites. The stock has gone from \$3 to \$12 since July, but there's more to go.

Comcast is another good bet. They acquired AT&T's cable operations, and they're good at improving systems they buy. They'll eventually sell higher-margin packages to those new customers. The stock is half its 2001 peak of \$40.

BW: Thank you all.



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Yes.



THE NATURE OF WHAT'S TO COME™

The Bull In the Ball

Strategists and portfolio managers see a Dow rally in '03. But then, they saw one in '02, too. **BY LEWIS BRAHAM**

OH, WELL.... For the third straight year, the stock-market forecasters surveyed by *BusinessWeek* vastly underestimated the bear market's severity. While they projected on average that the Dow Jones industrials would end the year at 11,090, the index stood at 8646 on Dec. 6, when the contest ended. Even Bernie Schaeffer, the seer most on target, overestimated the Dow by 4% (page 108).

Will the forecasters, who work as investment strategists or portfolio managers, fare better in 2003? The last three years haven't dampened their enthusiasm. Their outlook for 2003 is even more bullish than a year ago. The 67 prognosticators, who responded to our annual questionnaire, show an average 17% rise in the Dow by yearend to 9871, an 18% boost in the Standard & Poor's 500-stock index to 1049, and a 25% leap in the NASDAQ Composite Index to 1703. These expectations may turn out to be tame if the bear

goes back into hibernation: The last great bear market ended in 1974, and the Dow rose 39% and the S&P, 31.5%, in 1975.

There are some big differences between this bear market and the one in the '70s. Then, the U.S. had high inflation and stocks had low price-to-earnings ratios. Now we have low inflation and high p-e ratios. So if stocks are to soar, earnings need to stage a big comeback. "The key is profit-margin expansion," says Jeffrey Kleintop, chief investment strategist of PNC Advisors. That will happen, he says, as companies use increased productivity to contain labor costs. He forecasts 12% profit growth on a 6% increase in sales.

Kleintop's prediction is right in line with the average forecaster, who expects a 12.3% earnings gain. But within that average is wide variation, from as little

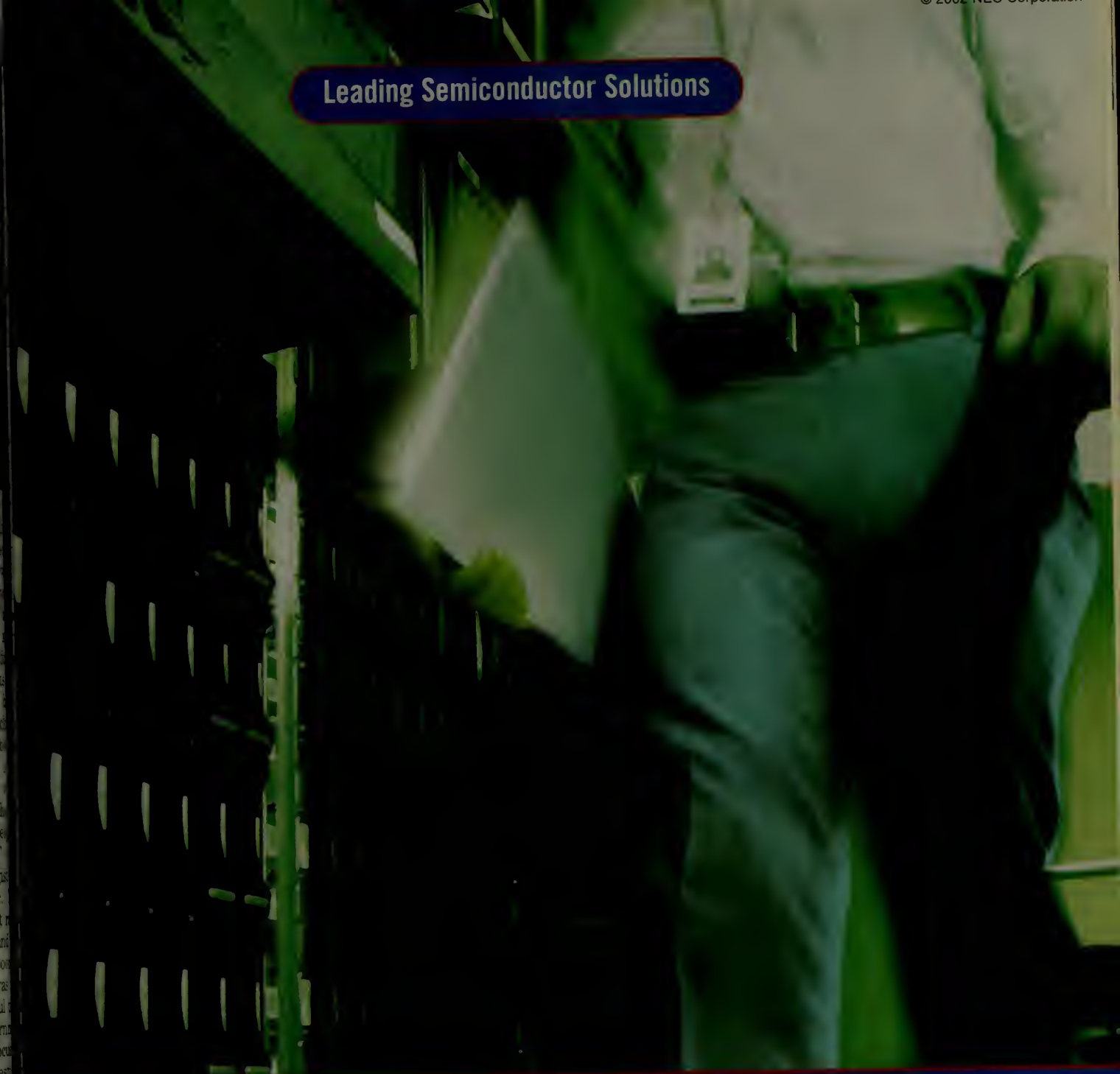
as 3% to a plump 40%. James Paulsen, chief investment officer at Wells Capital Management, projected the biggest gain because of the economic policy stimulus of lower interest rates and increased fiscal spending. By contrast, Richard P. CIO of Julius Baer Investment Management Inc., who sees only a 5% increase, thinks profits will be held back by the costs of funding pension plans drained by the bear market.

STICKING WITH STOCKS

Despite their disparate outlooks, most forecasters strongly favor stocks over bonds. The average prognosticator recommends allocating 68% of your portfolio to stocks and 23% to bonds, with the remainder going to cash and alternatives such as gold, real estate, and hedge funds. "I think we have seen the low interest rates," says Peter Trapp, portfolio manager of Needham Growth Fund. Since bond prices fall when rates rise, Trapp thinks bonds will lag. His fund, which has put as much as 25% of its assets in bonds and cash during the bear market, is now almost 100% in stocks.

Just because the prospects for bonds look bad doesn't mean stocks are a pitch. "During the 1990s there were tremendous forces that came together to drive stocks up that are not likely to reappear for quite some time," says Laszlo Birinyi Jr., a stock strategist at Deutsche Bank Securities Inc. The decade started with high interest rates and a weak dollar. As rates fell and the dollar strengthened, it was a boon for the U.S. markets. It was a relatively peaceful time so the government could focus on domestic





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Prognosticators see earnings rising anywhere between 3% and 40%, depending on such variables as interest rates and the rising cost of funding pension plans

sues, says Birinyi. "We're not blessed with that today."

HEALTHY CHOICES

Without powerful macro forces behind the stock market, strategists stress stock selection, and health-care stocks are among seers' top picks. Drug titan **Pfizer** was the most popular health-care stock. Carlos Asilis of J.P. Morgan Chase & Co. cited Pfizer's "defensive characteristics, robust earnings growth outlook, and attractive valuation."

Technology and financial services were the second and third favorite sectors. "If it's going to be a good stock market in 2003, the sector that was

beat up the most will come back the most," says Hugh A. Johnson Jr., CIO of First Albany Cos. "That sector is technology." Johnson is buying **Cisco Systems**, which he says is sitting on \$20 billion in cash and is reasonably valued. "You want to pick something in the tech space that is going to be around at the end of 2003," he says. "This company is not going out of business." Another pick: **Microsoft**, which independent strategist Jeffrey M. Applegate says is valued at the low end of its historical p-e range.

Many strategists think banks will do

well as credit quality improves during recovery, and they can speed their lending. For this reason, **Citigroup** seems cheap to many, despite concerns about litigation woes with subsidiary Salomon Smith Barney. **Merrill Lynch & Co.** also cropped up as a company that has trimmed costs through staff cuts and business reorganizations.

Consumer staples stocks are the least popular. One-third of the strategists agree that steady food, beverage, and tobacco stocks aren't cheap and often trail other sectors in a bull market. Utilities and retailers also are out of favor.

Although they haven't had a great track record in recent years, 2003 could be the year the necks of the Fearless Forecasters are spared.

WINNERS

WHY THIS BEAR IS DANCING

You could call Bernie Schaeffer a contrarian's contrarian. One of the few *BusinessWeek* Fearless Forecasters a year ago who predicted the bear market would continue through 2002, he nonetheless bristles at the label. "Contrarians are kind of ornery guys who want to fight the tape," says the 55-year-old founder of Cincinnati's Schaeffer's Investment Research Inc. But the technical analyst was taking his cues from weak price and volume data in the market. While the bulls ran wildly off track, Schaeffer went bearish and nearly nailed four indexes—the Dow Jones industrial average, the Standard & Poor's 500, the Nasdaq Composite, and the Russell 2000, an index of small companies.

On Dec. 6, when *BusinessWeek* called the winner, **Schaeffer's picks were 4% off the Dow, 1.4% off the S&P, 5.5 % off the NASDAQ and the Russell.** He had some tough competitors: Douglas Cliggott, formerly of J.P. Morgan Chase & Co. but now president of B&P Research Office Inc., missed the Dow by a scant 1.6%, and Joseph H. Barthel of Farnestock & Co. came a hair-splitting 0.8% away from hitting



HOW SWEET IT IS: Schaeffer's top pick is Krispy Kreme, despite their 16% fall in 2002

the S&P. But Cliggott and Barthel overshot other indexes just enough so that Schaeffer's forecasts trumped in the overall tally.

The secret to Schaeffer's success has been exploiting disconnects between market fundamentals and investors' expectations. He predicted sell-offs in 2002 as hopes for a recovery were dashed. He's generally bearish, predicting the **Dow will bottom at 6000 before rebounding to 8500 by next December.** Ever the iconoclast, he's also predicting a sharp rebound in tech and says the NASDAQ will finish the year at 2200.

A tech rally aside, Schaeffer's favorite stock remains **Krispy Kreme Doughnuts Inc.**, which he has liked since its 2000 initial public offering. Last year, it was a great call, since it's down about 5% since the last survey and 16% year-to-date. Schaeffer thinks the company's consistent earnings growth justifies the high price for what many think is an overvalued stock. Eventually, he says, the short-sellers will "cry uncle, and that could lead to a buying stampede." Maybe then Schaeffer will sell.

Brian Hill

Our Winner's Winning Predictions

	DOW JONES INDUSTRIAL AVERAGE	STANDARD & POOR'S 500 INDEX	NASDAQ COMPOSITE INDEX	RUSSELL 2000 INDEX
SCHAEFFER'S FORECAST	9000	925	1500	375
ACTUAL*	8646	912	1422	397

*Contest ended Dec. 6, 2002.

Data: Bloomberg Financial Markets, *BusinessWeek*

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2003: The View from the Street

The BusinessWeek Market Survey

We polled some of the smartest players on Wall Street, and by a wide margin, they predict a significantly stronger market. A few even see the Dow breaking 11,000.

NAME/FIRM	DOW JONES INDUSTRIAL AVERAGE MIDYEAR YEAREND	S&P 500 YEAREND	NASDAQ COMPOSITE YEAREND	RUSSELL 2000 YEAREND	ASSET ALLOCATION* STOCKS BONDS CASH	FAVORITE STOCK SECTOR	FAVORITE STOCK
ELAINE GARZARELLI Garzarelli Capital	11201	11301	1175	2000	100 0 0	Consumer Durables	Citigroup
MICHAEL PAINCHAUD Market Profile Theorems	9300	11150	1134	1625	75 20 0	Technology	Electronic Data Systems
DENNIS FERRO Evergreen Investments	10000	11000	1185	1725	65 35 0	Financials	eBAY
ALLAN RONESS ASR Corporate Consultants	9888	10856	1149	1817	90 10 0	Financials	Liberty Media
JOHN REGAN Americal Investment Strategies	9700	10750	1150	1900	80 15 5	Technology	Dell Computer
JAMES PAULSEN Wells Capital Management	9500	10680	1025	1650	80 20 0	Technology	Fluor
TOBIN SMITH ChangeWave Research	10000	10600	1100	1800	70 20 10	Health Care	Patterson-UTI Energy
THOMAS McMANUS Banc of America Securities	10000	10550	990	1800	80 20 0	Ind. Cyclical	USA Interactive
C. KIM GOODWIN State Street Research & Management	9819	10507	1104	1791	78 19 3	Financials	Cisco Systems
STEVEN FOLKER Fifth Third Investment Advisors	10000	10500	1125	1800	80 20 0	Technology	
CHARLES BLOOD Brown Brothers Harriman	9500	10500	1250	2500	75 20 2	Health Care	Citigroup
SUBODH KUMAR CIBC World Markets	9450	10500	1150		80 20 0	Financials	North Fork Bank
JOSEPH BATTIPAGLIA Ryan Beck	9950	10450	1100	1650	70 30 0	Health Care	Citigroup
JEFFREY KLEINTOP PNC Advisors	9575	10450	1130	1710	85 10 5	Health Care	Altiel
GARY TAPP SunTrust Robinson Humphrey	9785	10410	1105	1810	80 15 5	Utilities	Guilford
DAVID KATZ Matrix Asset Advisors	9780	10370	1075		80 30 10	Technology	American International Group
TOBIAS LEVKOVICH Salomon Smith Barney	9850	10370	1100	1700	70 25 5	Financials	HCA
JOSHUA BROOKS Delaware Investments	9850	10300	1100	1735	85 35 0	Financials	Fiserv
CLARE ZEMPEL Robert W. Baird & Co.	9700	10300	1070	1705	85 15 20	Health Care	Liberty Media
BARRY HYMAN Independent Strategist	9400	10280	1100		70 10 20	Financials	Microsoft
JEFFREY M. APPELGATE Independent Strategist	9800	10100	1080	1610	70 20 10	Health Care	Best Buy
IVAN GEFEN vFinance	9400	10080	1080	1675	85 30 5	Retail	Johnson & Johnson
JASON TRENNERT ISI Group	9819	10011	1044	1771	70 30 0	Health Care	Checkpoint Software
RICHARD SICHEL Philadelphia Trust Co.	9525	10010	1106	2205	100 0 0	Technology	Motorola
ASHER PLAUT Brill Securities	9000	10000	1000	2000	53 25 0	Health Care	
PETER TRAPP Needham Investment Management	10000	10000	1000	1800		Health Care	

MOST POPULAR STOCKS

	NUMBER OF RECOMMENDATIONS
CITIGROUP	4
PFIZER	3
CISCO SYSTEMS	2
LIBERTY MEDIA	2
MICROSOFT	2

MOST POPULAR SECTORS

	NUMBER OF RECOMMENDATIONS
HEALTH CARE	17
TECHNOLOGY	14
FINANCIALS	14
INDUSTRIAL CYCLICALS	5

U.S. 1000 Needham Investment Management

RANGES

	HIGH	LOW	AVG.
DOW JONES INDUSTRIAL AVERAGE	11400	7600	9871
NASDAQ COMPOSITE	2100	1015	1703
S&P 500	1250	800	1049
RUSSELL 2000	655	390	467

JON BRORSON Northern Trust	8800	9850	1080	1620	75	15	10	UST
STUART FREEMAN A.G. Edwards & Sons	9300	9800	1100	455	70	20	10	Clear Channel Comm
J. THOMAS MADDEN Federated Investors	8300	9800	1020	1625	455	64	36	Honeywell
ANN CODY Hilliard Lyons	9350	9800	1000	1650	480	70	20	General Electric
NED RILEY State Street Global Advisors	9650	9800	1043	1600	460	70	20	NASDAQ 100 Trust
CHARLIE CRANE Victory SBSF Capital Management	9250	9794	1050	1850	445	75	15	Pfizer
RONALD GEORGE Summit Brokerage Services	9600	9750	1244	1810	60	0	15	Riverstone Networks
HARVEY HIRSCHORN Columbia Management Group	9500	9700	1050	1700	460	63	37	Utilities
JEFF KNIGHT Putnam Investments	9000	9650	1175	2250	475	45	45	Consumer Staples
HUGH JOHNSON First Albany	9000	9650	1050	1550	450	65	35	Technology
DONALD ROSS National City Investment Management	9367	9645	1014	1616	448	58	20	Financials
ROBERT REISER Balentine & Company	9162	9608	1030	1641	443	50	20	Financials
ROGER DeBARD iGlobal Capital	8000	9600	943	1500	420	70	30	Consumer Durables
EDGAR PETERS PanAgora Asset Management	8900	9555	990	1500	405	50	40	Financials
NICOLE MAGER HPC Capital Management	8846	9510	1001	1590	430	72	18	Health Care
WENDELL PERKINS Johnson Asset Management	9200	9500	1000	1585	445	60	38	Services
RICHARD JANDRAIN Banc One Investment Advisers	8500	9500	1000	1700	450	60	30	Services
ROBERT GAY Commerzbank Securities	9150	9500	1010	1565	430	80	15	Technology
CHARLES PRADILLA SG Cowen Securities	9100	9500	1100	1700	500	70	30	Consumer Staples
GEORGE JACOBSEN Trevor Stewart Burton & Jacobsen	9150	9500	1000	1625	420	69	31	Financials
MARK JORDAHL U.S. Bancorp Asset Management	9172	9482	1000	1625	70	30	0	Consumer Staples
TED TRUSCOTT American Express Financial Advisors	10200	9400	1020	1800	480	70	20	Technology
STEVE LEUTHOLD Leuthold Weeden Research	9400	9300	1050	1600	450	63	20	Health Care
HENRY HERRMANN Waddell & Reed Financial	9500	9300	975	1500	629	70	30	Health Care
JACK ABLIN Harris Trust & Savings Bank	9000	9300	985	1550	435	70	25	Financials
DON NESBITT Ziegler Investment Services Group	8200	9000	900	1300	450	60	40	Health Care
MICHAEL VOGELZANG Boston Advisors	7200	9000	1000	1500	390	60	20	Ind. Cyclical
MICHAEL FARRELL David L. Babson & Co.	9000	8800	930	1500	400	80	0	Financials
LASZLO BIRINYI JR. Deutsche Bank	6000	8500	950	2200	425	25	0	Technology
BERNIE SCHAEFFER Schaeffer's Investment Research	9500	8250	875	1250	53	42	4	Energy
RICHARD PELL Julius Baer Investment Management	9720	7800	910	1065	410	50	20	Utilities
LAWRENCE McMILLAN McMillanAnalysis	8100	7600	800	800	50	30	20	Health Care
CARLOS ASILIS J.P. Morgan Chase			1020		75	25	0	Health Care
ROD SMYTH Wachovia Securities			860		45	35	20	Consumer Staples
KARI BAYER PINKERNELL Merrill Lynch	9300	9871	1049	1703	467	68	23	7

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- BONDS
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- CASH
- OTHER



The forecasters we surveyed like stocks both at home and abroad, but they're not betting the bank on them. Even with record low interest rates, they still put 23% in bonds and 7% in cash.

Chart by Eric Hoffmann/BW

*Asset allocations do not total 100% because of allocations in other categories, such as REITS, gold, and hedge funds.



Way back in the late nineteenth century, Jules Verne, that master of science fiction, foresaw many of the technological wonders that are commonplace today. Everything from the submarine, to the airplane, to rocket travel in outer space. He also predicted that we'd have TV in another thousand years.

Yet, as far-reaching as Verne's imagination

was, even he would be somewhat astonished at the many marvels there are to be found in the Lexus ES 300.

One of these marvels would have to be the available rain-sensing windshield wiper system (Captain Nemo might want to take note of this one.) A sensor

employs reflected and emitted light to detect the presence of raindrops on the windshield

RAIN-SENSING
WINDSHIELD WIPERS.
EVEN JULES VERNE DIDN'T SEE
THIS ONE COMING.



Not only does the system switch the wipers on and off, but it will measure the degree of precipitation and increase the wiper speed as necessary. So no matter what the conditions are that you're facing, from a light drizzle to a heavy downpour, you are able to give the road ahead your full, undivided attention.

He would also find the available new Lexus DVD-based Navigation System quite fantastic.

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This NAV system can verbally direct you to nearly any destination within the contiguous United States* via three different routes: the quickest, the shortest and an alternative route.

These are two examples of the new world of luxury that awaits you in the ES 300. A car that was built on the idea that every journey, whether it be to the center of the Earth, or to the center of town, ought to be unforgettable.



Measures, traffic flow or other road system changes may affect the accuracy of the mapping software. Rely upon your common sense to decide whether or not to follow a specified route. Please always wear seatbelts, secure children in rear seat, obey all speed laws and drive responsibly. For more information, call 800-USA-LEXUS (800-872-5398).



Done With The Dow?

Here's a quick guide to some further options.

NOT WILLING to slog through thousands of company reports? This section *BusinessWeek's* Investment Outlook is for you. Mutual funds aren't guaranteed winners—only 1 of the 50 largest U.S. equity funds made money in 2002—but value-oriented managers are finding treasures in Wall Street's rubble (page 115). Bonds, look for shorter maturities and be sure to diversify (page 119). If you worry that ballooning credit and tax cuts may spark inflation, look at gold (page 122). And experts say art prices are high (page 125), so buy art for its psychic—financial—rewards.

Reign of the Value Funds

Small-cap specialists, in particular, have an edge.

BY MARA DER HOVANESIAN

WE ARE ALL value investors now. Three years into a bear market that wasn't supposed to last this long, mutual-fund managers have finally admitted that only the most buttoned-down strategies will save the day. The best stick with quality companies that have free cash flow, recurring revenues, and heavy insider ownership. "It's more like a religion than an investment approach," says Charles R. Dreifus, manager of the \$300 million Royce Special Equity Fund, which had just \$6 million in assets a year ago. Smart investors who flocked to Dreifus' fund could see that his disciplined approach to small-cap value investing was paying off: The diversified equity fund—No. 1 in a cast of thousands—is up 16.5% through Dec. 12. Dreifus looks for companies with a high return on assets and low debt. Says the 34-year investment veteran: "I hate to lose money."

Nobody does, but it hasn't been easy to dodge disaster. Even the most cautious fund managers have been mauled of late. The Auxier Focus Fund—up 12.7%, vs. the 13% loss of the Standard & Poor's 500-stock index—was a standout in 2001 because of manager J. Jeffrey Auxier's sensitivity to price and his penchant for steady growth securities that the market neglects. The fund's 7% loss in 2002 beats most equity funds by a mile, but it has been a rough haul: "It's not as much fun, and it's a lot more work," he says. He's still buying beaten-down stocks with long track records of quality earnings growth—such as oil-and-gas contractor Willbros Group Inc. and Concor-

dia Investment, a bill processor—to boost next year's returns.

There's no quick payoff with Auxier's level-headed style. Still, it's a stock-picking strategy that seems to have finally caught on among managers of all stripes, even those running aggressive growth and telecom funds. In the November rally, when tech funds gained 17%, value funds beat growth funds—the opposite of what had happened throughout the 1990s. Analysts say that points to two important changes:

fund: "If we are buying Citigroup at \$30, we sure hope it's good value—and that it's going to grow." He's sticking with companies that trade at low-double-digit price-earnings ratios and use cash to buy back shares, such as Republic Services Inc. and Waste Management Inc., both waste-handling companies. "We look for business models that just chug along," he says.

The more managers who adopt Smith's steady-as-she-goes thinking, the better off investors may be. But there's still a long way to go: So bleak is 2002's performance that the 1% gain in lowly money-market funds clobbered an army of stockpicking pros. The average actively managed U.S. diversified fund lost 20.4% through Dec. 12, vs. a 20.3% decline in the S&P—certainly nothing to brag about. The only stock funds to best 19 categories of chart-topping bond funds were those that buy gold-mining and other precious-metal stocks, up 56%. Real estate funds' 3.3% gain offered the only other positive return among stock funds. Everything else was under water.

Only one fund among the nation's 50 largest—which buy both U.S. and foreign stocks and account for 42% of the industry's \$6.2 trillion in assets—made a penny for investors this year. The \$8.3 billion Vanguard Wellesley Income Fund gained 3.5%, primarily because of a 60% stake in bonds. Managers argue that accounting fraud and other corporate misdeeds at the big companies they tend to buy are still working through the market. "These weren't even on the table when we started the year," says Bartlett R. Geer, lead manager of the \$2.2 billion Putnam Equity Income Fund. "Just because it's the end of the year doesn't mean we aren't still having to deal with that legacy."

But the future holds promise for small-company specialists. Value-oriented funds, such as the Royce Special Equity Fund and the value-growth blend of Bridgeway Ultra-Small Co. Fund, up 5.3%, have eclipsed large-cap offerings since 2000. Small-cap value funds collectively posted losses of 10.7% through Dec. 12. That doesn't sound like much, but it beats other value funds of all market-cap sizes and is miles ahead of growth-stock funds. Most managers expect more of the same because small stocks tend to out-

HOW THE BIG FUNDS FARED

NAME	NET ASSETS* BILLIONS	TOTAL RETURN**
Fidelity Magellan	\$58.0	-21.4%
Vanguard 500 Index	56.2	-20.3
Investment Company of America A	45.3	-13.6
Washington Mutual Investors A	41.4	-14.3
Standard & Poor's Depository Rcpt.	40.4	-20.3
Growth Fund of America A	30.9	-19.6
Fidelity Contrafund	28.0	-9.3
Fidelity Growth & Income	26.7	-17.1
EuroPacific Growth A	22.4	-13.3
New Perspective A	21.9	-14.9

*As of Oct. 31, 2002

**Appreciation plus reinvestment of dividends and capital gains before taxes, Jan. 1 through Dec. 12, 2002

Data: Standard & Poor's

Growth managers have shed risky tech stocks, and managers in search of inexpensive picks are dominating the market. The argument goes that if investors oriented toward fundamental analysis and nitty-gritty balance-sheet work are a major force, then the rally will be broad and lasting.

Growth managers readily admit they are weaving a value thread into their stockpicking. Says Robert W. Smith, manager of the \$4 billion T. Rowe Growth Stock Fund, down 22%, vs. 25% for the average large-cap growth

perform in recoveries. What's more, many large companies—aside from blue-chip, U.S. multinationals that will get a boost from a falling dollar—are still projecting less than modest growth.

As company earnings improve next year, small-cap funds are likely to show positive returns, say the pros. A. Lanny Thorndike, fund manager of the \$26 million Century Small Cap Select Fund, up 2%, expects single-digit earnings growth. "We're looking for steady Eddie," he says. Thorndike seeks companies with high recurring revenues that have earned at least 15% to 20% returns on equity annually for five years. He figures

such stocks could double three years from now. His favorites include Portfolio Recovery Associates, a debt collection business; Medical Waste Disposal; and Stericycle, a medical-waste company.

Haven't heard of those companies? Managers destined to stay on top next year will likely gravitate toward unknown and unloved stocks of the high-quality variety. And should the stock market continue along its volatile trajectory, managers with flexible fund charters, allowing them to hold lots of cash, sell stocks short, or invest in bonds, may keep their competitive edge. Terry Coxon of the Permanent

Fund, which has just such a go-anywhere strategy, has earned his investors 12.7% this year, earning his fund a No. 56 ranking in the industry. Lately, he has had a conservative mix of investments in Swiss francs, real estate investment trusts, bonds, and natural-resource stocks, such as Chevron, Texaco and Burlington Resources Inc. Other winning equity funds with similar strategies include the Comstock Capital Value Fund, up 31.7%, and the Yacktman Focused Fund, up an annual 15% over the past three years.

High cash holdings have been a boon even for tech-fund managers. Zach Shafraan, manager of the Waddell Reed Advisors Science & Tech Fund, has lost 27%, vs. the industry's 39% average. He says tech stocks are still too expensive and has stashed 30% of the fund's assets in cash, up from his usual 10%. He has also relied on health-care companies, such as Alcon Inc., a global ophthalmology company recently spun off from Nestlé. "Tech stocks have gone from extremely overpriced to just overpriced," echoes John L. Rutledge, of the \$12 million Evergreen Technology Fund. He has stayed afloat by sticking to the information-technology services sector with stocks such as First Data Corp. and Affiliated Computer Services.

Bond fund managers have been reigning champions for three years. But the pros are preaching caution for next year. Their best advice: Stay short. Five- to 10-year bonds are the riskiest now because of the likelihood that interest rates will rise. Luckily, some corporate bonds now show promise. "What you find there are quality companies that are going through a period of transition," says Marc P. Seidman, senior fixed-income strategist at Standard & Poor's, Ayer & Wood, which manages \$3 billion, mostly in bond assets. "The credit ratings and yield spreads do not fully reflect the improving business fundamentals."

The attraction is high yields averaging about 10%. But there's an important caveat: "The big mistake right now is for investors to chase yield," says Daniel J. Genter, president of RNC Capital Management LLC, a Los Angeles investment firm that manages \$1.3 billion. Genter doubled his stake in corporate bonds in the fourth quarter—but there are risks of downgrades. "When you move away from Treasuries, cash flow and corporate issues affect these bonds, so be picky," he says.

International managers who take a conservative approach were also at

THE BEST EQUITY FUNDS

FUND	TOTAL RETURN*	FUND	TOTAL RETURN*
First Eagle SoGen Gold	93.8%	AXP Precious Metals Y	53.1%
Monterey OCM Gold	81.2	Midas	51.6
Van Eck Intl. Investors Gold A	76.8	INVESCO Gold & Precious Metals Inv.	51.5
Gabelli Gold	75.9	Fidelity Select Gold	51.4
Tocqueville Gold	73.3	Rydex Precious Metals	43.5
U.S. Global Inv. Gold Shares	68.9	Rydex Dynamic Venture 100	36.7
U.S. Global Inv. World Prec. Minerals	64.6	Oppenheimer Gold & Spec. Minerals A	34.7
Amer. Century Global Gold Inv.	61.1	ProFunds UltraShort OTC Inv.	34.6
Prudent Bear	59.2	ProFunds UltraBear Inv.	32.2
Evergreen Precious Metals Holdings I	59.0	Comstock Capital Value R	31.7
ING Precious Metals	57.2	Rydex Dynamic Tempest 500	31.6
USAA Precious Metals & Minerals	57.2	U.S. Glob. Accolade Regl. Eastern Euro	31.0
Scudder Gold & Precious Metals S	54.0	Franklin Gold & Precious Metals	29.5

*Appreciation plus reinvestment of dividends and capital gains before taxes, Jan. 1 through Dec. 12, 2002

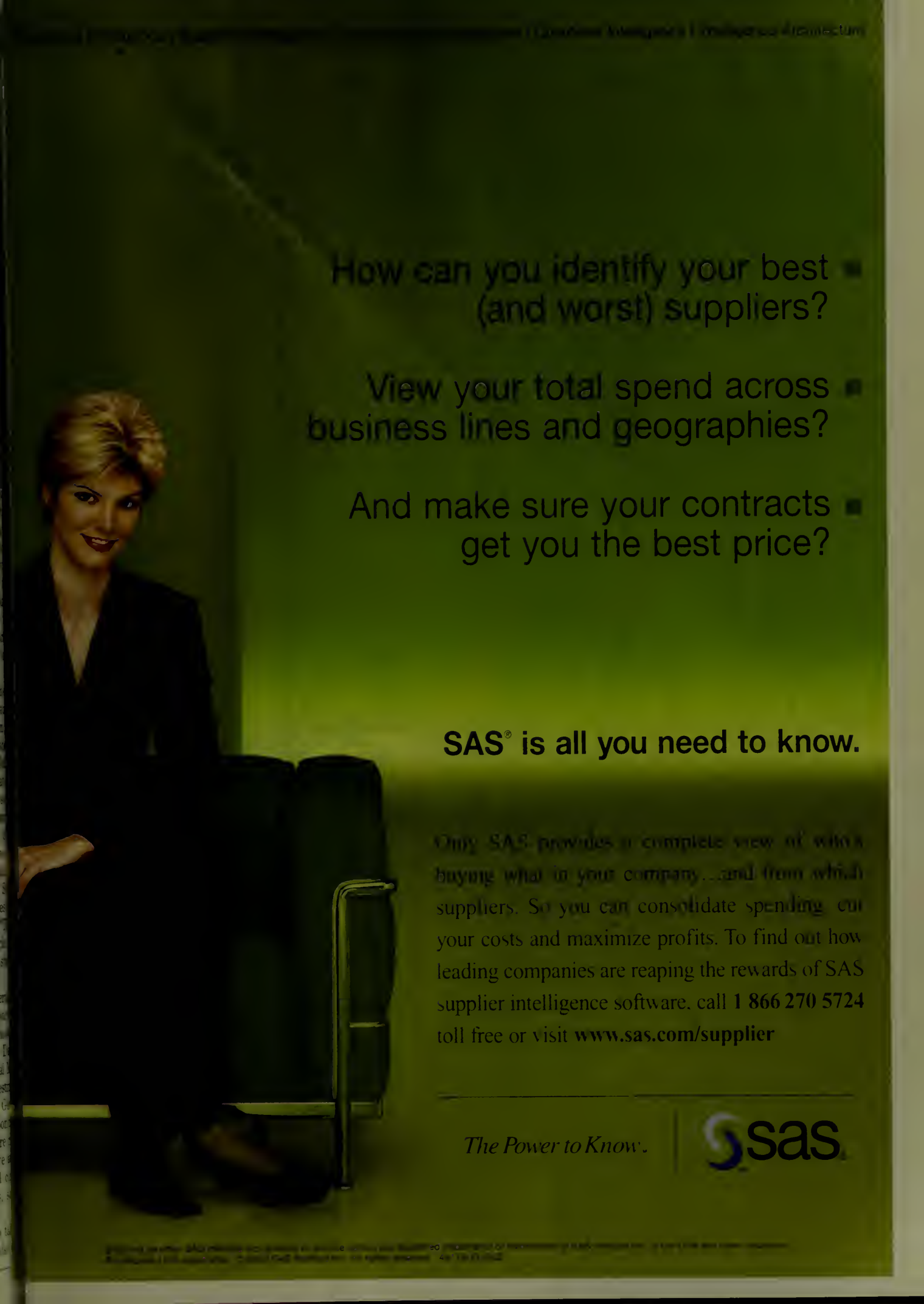
Data: Standard & Poor's

THE WORST EQUITY FUNDS

FUND	TOTAL RETURN*	FUND	TOTAL RETURN*
ProFunds UltraWireless Serv.	-77.9%	Monterey Murphy New World Biotech.	-53.4%
ProFunds UltraOTC Inv.	-65.6	iShares Goldman Sachs Netwkg. Index	-52.6
Van Wagoner Post Venture	-65.3	Conseco Science & Technology Y	-52.5
Rydex Dynamic Velocity 100	-64.5	Fidelity Select Wireless	-52.3
Black Oak Emerging Technology	-63.8	Red Oak Technology Select	-51.5
Van Wagoner Technology	-63.4	Firsthand Technology Innovators	-51.3
ProFunds UltraSemicond. Inv.	-63.3	PBHG Technology & Communications	-51.2
Van Wagoner Emerging Growth	-62.4	IDEX PBHG Tech. & Comm. A	-50.9
World GenomicsFund.com	-59.3	Wireless	-50.9
Firsthand Communications	-57.1	Firsthand Global Technology	-50.8
Amerindo Health & Biotech A	-56.4	Pioneer Science & Technology C	-50.6
Berkshire Focus	-53.9	ProFunds Biotech Ultrasector Inv.	-49.8
Firsthand Technology Value	-53.4	PIMCO PEA Innovation	-49.0

*Appreciation plus reinvestment of dividends and capital gains before taxes, Jan. 1 through Dec. 12, 2002

Data: Standard & Poor's



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BOND FUNDS CAME THROUGH AGAIN

CATEGORY	TOTAL RETURN*	CATEGORY	TOTAL RETURN*
Long Government	11.7%	Intermediate (General)	6.7%
International Bond	10.6	Muni. Calif. Intermediate	6.3
Emerging Markets Bond	9.5	Short Government	5.4
Intermediate Government	8.2	Multisector	5.4
Muni. New York Long	7.8	Muni. High Yield	4.9
Muni. National Long	7.4	Short (General)	4.1
Muni. National Intermediate	7.1	Muni. Short	3.6
Muni. Single-State Long	7.1	Ultrashort	2.5
Long (General)	7.0	High Yield	-2.2
Muni. Calif. Long	6.9		
Muni. New York Intermediate	6.9	All Taxable Bond	5.29
Muni. Single-State Intermediate	6.9	All Non-Taxable Bond	6.98

*Appreciation plus reinvestment of dividends and capital gains before taxes, Jan. 1 through Dec. 12, 2002

Data: Standard & Poor's

ply rewarded in 2002. The Commonwealth Australia/New Zealand Fund, No. 42 of all funds, is up 17.4% by favoring Old Economy stocks such as Williams & Kettle, an agricultural supplier, and Northland Port.

Emerging markets are also coming out of a deep slumber, says Mark Madden, manager of \$1.2 billion in emerging-market assets for Pioneer Investments in Boston. His biggest sector weighting is in financials, at 17% of as-

sets. His picks include Thailand's Bangkok Bank, one of the largest in the country, and Korea's Shinhan Bank. "We hit bottom two years ago," he says. "But the recovery in these companies was delayed by the slow economic global environment."

The pace of economic recovery isn't expected to pick up anytime soon, either in the U.S. or abroad. As long as it stays slow, a steady investment strategy will continue to win the race. ■

A BOTTOM FOR EQUITY-FUND RETURNS?

CATEGORY	TOTAL RETURN*	CATEGORY	TOTAL RETURN*
Precious Metals	55.1%	Large-Cap Value	-18.0%
Real Estate	3.3	World	-18.7
Natural Resources	-4.8	All Cap	-19.4
Pacific/Asia ex-Japan	-5.3	Large-Cap Blend	-19.9
International Hybrid	-7.5	Latin America	-22.8
Convertibles	-8.4	Utilities	-24.4
Financial	-8.5	Large-Cap Growth	-24.8
Domestic Hybrid	-9.7	Mid-Cap Growth	-24.8
Diversified Pacific/Asia	-9.9	Small-Cap Growth	-25.9
Small-cap Value	-10.7	Health	-28.3
Mid-Cap Value	-12.6	Technology	-38.9
Miscellaneous	-13.8	Communications	-38.9
Japan	-14.8	U.S. Diversified Funds	-20.4
Mid-Cap Blend	-15.9	International Equity Funds	-14.4
Foreign	-15.9	All Equity Funds	-17.9
Europe	-16.1	S&P 500, including Dividends	-20.3
Small-Cap Blend	-16.8		

*Appreciation plus reinvestment of dividends and capital gains before taxes, Jan. 1 through Dec. 12, 2002

Data: Standard & Poor's

Q&A

ANOMALY HUNTER



Charles R. Dreifus, who runs the \$300 million Royce Special Equity Fund, combines classic value analysis with accounting skepticism. His

was the top diversified equity fund in 2002, earning 15% through Dec. 12. Dreifus runs a concentrated portfolio of about 70 holdings in small-cap companies with average price-earnings ratios of 13. A typical pick is Menasha (Wis.)-based Banta Corp., a humdrum printing and digital imaging firm with fat margins, double-digit profit growth, and \$6 of cash per share.

Q: What's so "special" about the Royce Special Equity fund?

A: These aren't just small- and micro-cap value stocks, but truly anomalies in their group. They are very conservatively financed and managed and owner-operated. A common thread is a larger-than-average, family-type ownership.

Q: You use a strict metric to screen companies. Can you explain?

A: We start with enterprise value, the market price one would pay to buy the company. We divide that by trailing 12 months' earnings before interest and taxes—EBIT, without depreciation and amortization. The way you can find out if the company is producing a return that's greater than the cost of its capital. If so, you make money. But I do not buy off this list. Most are rejected.... I take this to the nth degree.

Q: You've always had a keen interest in the books. Why?

A: I'm very, very blessed with a passion for what I do. I enjoy and have a great passion for interpreting financial statements. I actually enjoy reviewing the SEC filings and try to get a sense of what's going on. Of course, if there's outright fraud, I won't find it.

The Picking Will Get Trickier

Bonds won't do as well they've done in recent years, but you can still find smart buys. **BY SUSAN SCHERREIK**

BONDS HAVE enjoyed three boffo years, but don't expect a repeat performance in 2003. What's the best strategy? Seek out deals with the best relative value. In the high-quality area, you'll find better value in Treasury Inflation-Indexed Securities (widely known as TIPS) than in plain-vanilla Treasuries. Tax-exempt municipal bonds and mortgage-backed securities are also excellent choices. For investors willing to reach more risk, high-yield corporate bonds show perhaps the highest potential returns of

in 2002, the biggest worry in the bond market was credit risk as investors watched investment-grade players such as Enron Corp. and WorldCom go belly-up. Even when there are no financial shenanigans, a weak business climate usually leads to downgrades in credit quality. But as the economy snaps back, interest-rate risk becomes a

bigger threat than credit risk.

To guard against erosion in the prices of bonds you own as rates rise, choose securities with shorter maturities. "You need to move in on the yield curve," says Robert

V. Gahagan, head of taxable fixed-income investing at American Century Investments. He advises sticking with bonds that mature in seven years or less because if rates rise, the prices of the bonds will decline less than those of longer-dated issues.

Another way to protect your portfolio is to invest across fixed-income classes. To help you diversify wisely, here's what to expect in the different sectors.

HIGH-YIELD BONDS

There are good reasons why these securities, better known as junk bonds, yield a huge 8.81 percentage points over Treasuries with comparable maturities: widespread bankruptcies and fears that the fledgling economic recovery could stall out. Still, the income these bonds throw off may more than justify the risk.

For one thing, the percentage of outstanding junk-bond debt in default, which soared from 2% in 1998 to 9.8% in August, has begun to edge lower, to 8.7% recently—its lowest level since June, 2001, according to Moody's Investors Service. "We're already seeing a turnaround," says Margaret D. Patel, portfolio manager at Pioneer High-Yield Fund. She notes that the yield gap between junk bonds and Treasuries stood at a much wider 10.9 points in October, an indication that investors are beginning to wade back into the junk-bond market.

Patel argues that the yield gap will continue to narrow as the economy shows further signs of improvement in 2003. That's good for investors who al-



High Bids

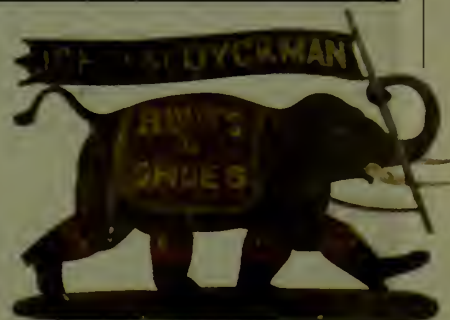
Prices paid for these pieces at Christie's 2002 auctions surprised the experts. Look for continued length in these areas.



ANCIENT ARMS AND ARMOUR
Greek bronze cuirass, late 7th century B.C. Estimate: \$78,000 to \$120,000. Sold: \$194,111.

JEWELRY AS ART

Multijeweled bracelet mounted in silver and gold. Estimate: \$150,000 to \$200,000. Sold: \$556,000.



WHIMSICAL AMERICANA
Painted wooden sign from a 19th century cobbler. Estimate: \$30,000 to \$50,000. Sold: \$113,525.

ready own the bonds since prices rise when yields fall. She says 30% of her fund's \$3.6 billion in assets are invested in the debt of cyclical companies, including auto suppliers and industrial and transportation companies, which stand to benefit as the economy picks up steam.

MUNICIPAL BONDS

For the first time in 16 years, yields on top-quality munis are equal to or higher than yields on comparable Treasuries. Today, an AAA-rated 30-year muni yields 5%, vs. 4.9% for a 30-year bond. For an investor in the 30% income tax bracket, that means a 30-year muni yields an even juicier 7.1% after taxes.

Munis are carrying such high relative yields because, with interest rates

In contrast, notes American Century's Gahagan, high-quality corporate bonds, such as those issued by Wal-Mart Stores Inc. and PepsiCo Inc., outyield Treasuries by a scant 0.3 to 0.7 percentage points.

Sure, if rates rise, he says, the mortgage securities will suffer some price decline, but the overall return will still be strong because of the relatively higher yield. Then again, an uptick in rates will slow the pace of homeowner refinancings, which means that higher-yielding mortgage securities would more likely stay in investors' hands.

TREASURIES

Despite their reputation for safety, U.S. Treasuries are riskier than they've been in years. For one thing, the market is likely to see a gusher of new supply as

Washington borrows to pay for a military buildup and to deal with tax-revenue shortfalls. "Treasuries are going from being scarce to being plentiful—and we are looking at federal budget deficits as far as the eye can see," says Daniel C. Dektar, chief investment officer at investment management group Smith Breeden Associates Inc.

That's not all. If interest rates rise, Treasuries will see more price erosion than other sorts of bonds because Treasury yields have fallen more sharply, says T. Rowe

Price's Miller. "If you are buying Treasuries, stick with maturities of six months or less." That way, if rates rise, you can invest in higher-yielding bonds.

Another way to protect against rising rates is to invest in TIPS, as the Treasury's inflation-proof bonds are called. In addition to making semiannual interest payments, TIPS adjust their principal value twice a year to reflect inflation, as measured by hikes in the Consumer Price Index.

TIPS recently yielded 2.5%, vs. 4.1% for a 10-year Treasury, resulting in a "breakeven" inflation rate of 1.6%. That means inflation needs to remain above 1.6% over the next decade for TIPS to outperform conventional bonds. Since the inflation rate has averaged more than 4% annually over the past 40 years and is forecast to be 2.2% in 2003, TIPS seem to be an investor's best bet in the Treasury bond market. ■

How They Compare

INVESTMENT	AVERAGE YIELD*
High-Yield Bonds As the economy snaps back, junk-bond prices should continue to rise	12.3%
Mortgage-Backed Securities Securities issued by Ginnie Mae, Fannie Mae, and Freddie Mac yield 1.8 percentage points more than Treasuries	5.4%
Municipal Bonds For the first time since 1986, high-quality, tax-exempt munis yield as much and sometimes more than comparable Treasuries	5.0%
Treasury Inflation-Indexed Securities (TIPS) As long as inflation averages above 1.6% over the next decade, TIPS will outperform regular Treasuries	2.5%

*Dec. 13

Data: Merrill Lynch & Co., Smith Breeden Associates, *BusinessWeek*

so low, states and local governments have flooded the market with new supply. Mary J. Miller, assistant head of fixed-income investing at T. Rowe Price Group Inc. allows that budget woes are likely to lead to credit downgrades of some state and local governments, but she doesn't expect a serious wave of defaults. She also believes an improving economy will help municipalities get back on their feet. "We may be at the worst point in the cycle right now," says Miller.

MORTGAGE-BACKED BONDS

Securities issued by Fannie Mae, Freddie Mac, and Ginnie Mae offer plump yields that are about 1.8 percentage points above comparable Treasuries, plus high credit quality. (Only Ginnie Mae's are backed by the full faith and credit of the U.S. government. The other two are government-sponsored enterprises.)

Q&A

BONDS HAVE MORE FUN



Mary J. Miller, assistant director of T. Rowe Price Group Inc.'s \$45.5 billion fixed-income division and portfolio manager of the T. Rowe

Price Tax-Free Income Fund, has been a bond investor for 20 years. She spoke recently with Personal Finance Editor Susan Scherreik.

Q: What's ahead for the bond market?

A: Fixed-income performance in 2003 is more likely to be driven by sector choices than by interest rates. High-yield corporate bonds, mortgage-backed securities, and tax-exempt municipals look most attractive.

Q: Don't many state and local governments have serious fiscal woes?

A: Yes, but remember state and local governments don't go bankrupt. They'll find a way through this painful period and come out in better shape.

Q: What don't you like?

A: Treasuries look problematic. There's been such a huge move into short-term Treasuries by risk-averse investors that there's not much room for any further price appreciation.

Q: Do you worry about deflation?

A: There are pockets of deflation, such as in telecommunications and technology sectors, but we don't expect it to spread to other parts of the economy.

Q: What's your forecast?

A: We see the economy getting back on its feet in 2003 while inflation stays tame. As a result, short-term rates will edge up while long-term rates hold fairly steady.



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Model	1560V	1560NX	1560M	1760V	1760NX	1760VM	1860NX
Rapid Response	No	Yes	Yes	Yes	Yes	Yes	Yes
Thin Frame	Yes	Yes	Yes	Yes	Yes	Yes	Yes
DDC/CI	No	No	Yes	Yes	Yes	Yes	Yes
No Touch Auto Adjust	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Integration Capable	Yes	Yes	No	Yes	Yes	No	Yes
LiquidView™ Software	No	No	No	Yes	Yes	Yes	No
Multimedia	No	No	Yes	No	No	Yes	No
Vacation Switch	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Cable Management	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Input Interface Connectors	VGA	DVI-D & VGA	DVI-D & VGA	VGA	DVI-D & VGA	DVI-D & VGA	DVI-D & VGA

CLASSY COINS

One way to make a buck is to collect it. Although there's rarely a roaring bull market in coins, you can earn some steady gains over 20 years or so. Here are a few types that should do well:



CLASSIC ERA COMMEMORATIVE COINS Silver dollar issued in 1900 to honor General Lafayette. Good-quality piece worth about \$10,000.



EARLY INDIAN AND LINCOLN PENNIES

Indian pennies, 1859 to 1909; Lincoln pennies, 1909 to 1929. Starting at \$100. An 1877 penny: \$1,500.

COLONIAL AMERICAN COINS

High-grade New Jersey or Connecticut coppers, circa 1785-88. Starting at \$100. A 1776 Continental dollar: \$20,000.



Data: Bowers & Merena Galleries

Gold Keeps Looking Shinier

There are plenty of reasons to think the rally will continue. **BY MARA DER HOVANESIAN**

Gold bugs, rejoice: Prices broke \$330 per ounce on Dec. 13, further fueling the yearlong bull run in gold-mining stocks. Those smart enough to invest in gold and precious metals funds at the start of 2002 have earned an average 56% return—the best performance of any mutual fund category in the period. “People just don’t believe it,” says Morgan Stanley’s gold analyst, Michael Durose. But that’s because they may not understand the dynamics. On average, every 1% increase in the price of gold leads to a 3% increase in the value of mining stocks, he says. “You get that kind of leverage because costs are fixed, and reserves are more valuable,” says Durose. Ultimately, the industry’s profits are enhanced.”

There are technical reasons why gold prices spiked, say enthusiasts. Hedge-fund managers, who make bets on geopolitical and economic changes, are buying en masse, propping up prices. Also, as gold-mining stocks soar, short-sellers who had bet on price declines are scrambling to cover their positions.

Skeptics say the rally won’t last. Spikes are nothing new: Gold last reached \$338 in October, 1999, when 15 central banks signed a pact to limit their lending and sales of metals for five years. Prices also shot up after the terrorist attacks of September 11, as investors fled to safe, tangible assets.

But the industry has gone through a metamorphosis that bodes well for the

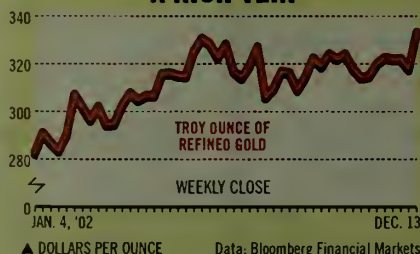
long term. Twenty-year lows in gold prices forced mining companies to streamline operations. Some are now earning their first profits in years. Rampant consolidation and lack of money for exploration have cut supply, boosting prices. That’s not all: The threat of war and other uncertainties have added to demand from speculators. The weakening of the U.S. dollar will also help to keep prices aloft. As it stands, most analysts expect gold to reach \$350 in the

first half of the year. “I don’t think it’s too late to buy gold stocks,” says equity metals analyst Les Larkin of Standard & Poor’s.

Once a rally starts, watch out, says Frank Holmes, CEO of San Antonio’s U.S. Global Investors Inc. He runs two gold-related funds, which are among the best performers of U.S. diversified stock funds. The U.S. Global Investors World Precious Metals Fund, which buys North American mining companies, is



A RICH VEIN



64% so far this year. In stimulative cycles, after the economy turns bad, with low interest rates, deficit spending, and weakening currency, “the gold stocks take off,” he says. “We’re more than a year into it, but we think 2003 is going to be another bull market in gold stocks. Gold shines when everything else falls apart.”

Word to the wise: Don’t try to time the gold market and chase returns. Holmes advises stashing 5% of a portfolio in physical gold or stocks, rebalancing every six months. If you don’t, you risk tarnishing an otherwise bright investment move.

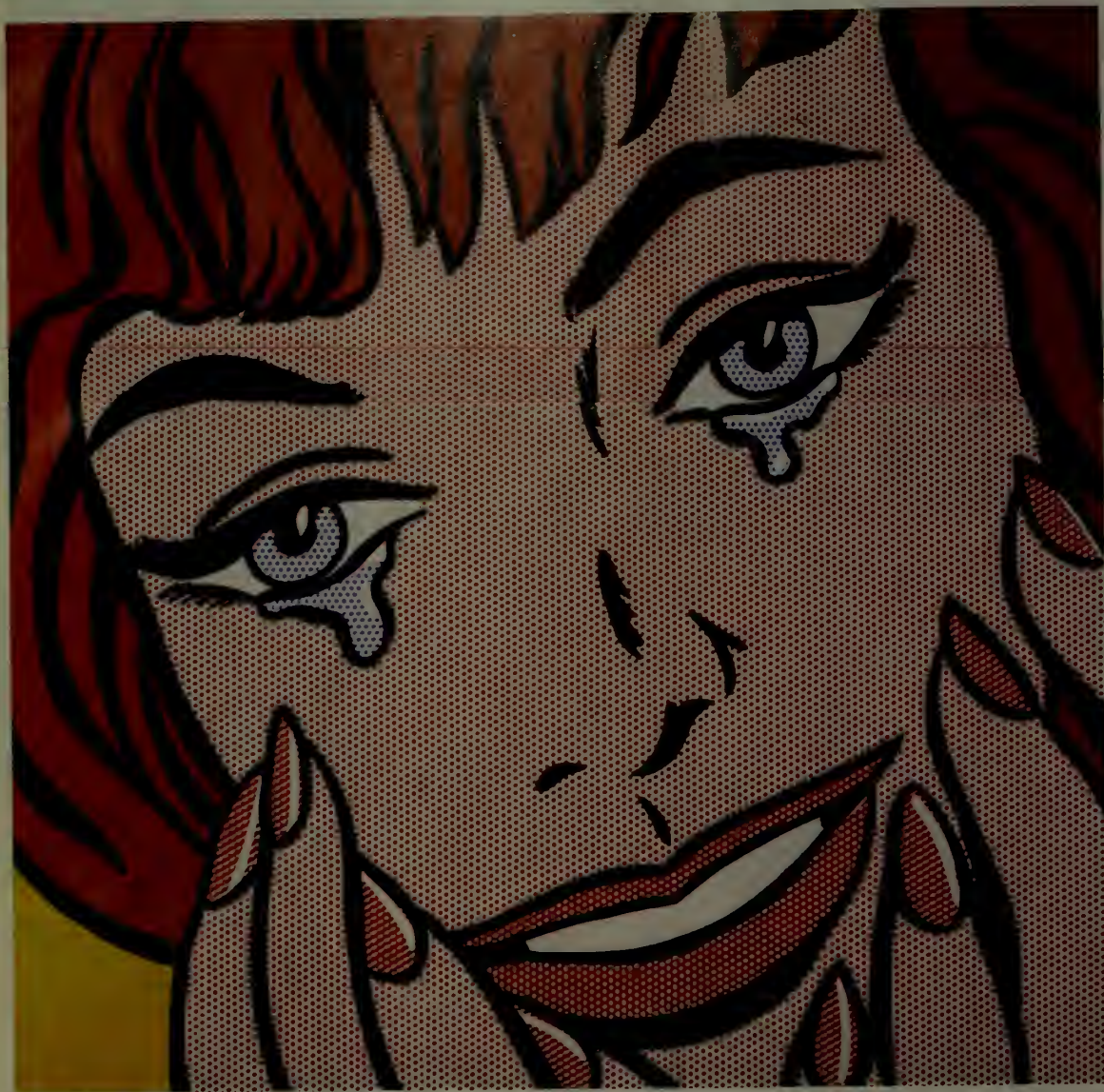


THE RESTYLED 2003 AVALON. With a car this luxurious, only one question remains—sparkling or still?

GET THE FEELING



 **TOYOTA**


**SOMEONE
WASN'T SAD:**

Contemporary art fetched fat prices this year, including *Happy Tears* by Lichtenstein

fell 15%, the first such drop in a decade, according to Artprice.com, a French outfit that tracks auction results. The main reason: American sales plunged 47% in September because of September 11 anniversary jitters, an indication of what might happen if war with Iraq breaks out. If you include gallery and dealer sales, the world art market may not have grown at all last year: Dallas economist David Kusis figures it totaled about \$23.5 billion, the same as in 2001.

Even in contemporary art, where prices are climbing, such well-known collectors as San Francisco investor-banker Thomas Weis and German real estate developer Hans Grottel are selling more than they're buying. "Most of the world is struggling with economic problems,"

Is It Crying Time Again?

The hot art market could be ready for a downturn.

BY THANE PETERSON

DON'T LET THOSE heady art auction sales fool you. Despite records set in the November auctions for dozens of mainly contemporary artists, including Roy Lichtenstein, David Hockney, and Barnett Newman, some signs suggest the market may have peaked.

Careful collectors can still find reasonable prices by combing through overlooked segments such as 18th century paintings, or by identifying promising young artists whose prices have yet to soar. Just be aware that for many other types of works, if you pounce now, you may be buying near the top.

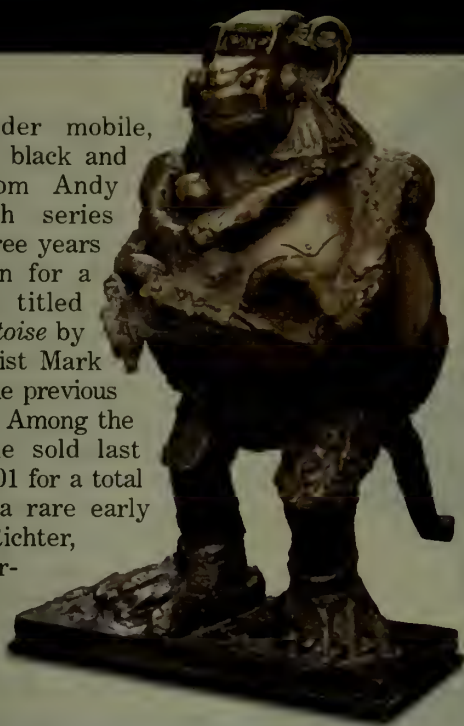
That sentiment began to take hold in the third quarter, when world art prices

yet art prices just keep increasing, says Ingvild Goetz, a major Munich collector. "I don't get it." Adds Los Angeles collector Eli Broad: "I cannot imagine the market going higher. If anything, I still believe there should be a [price] adjustment."

Of course, good works command high prices in almost any market. *The Massacre of the Innocents*, a rare Peter Paul Rubens found hanging in an Austrian monastery, sold for \$76.7 million at a Sotheby's auction in London last July. A bronze baboon set a world record for a Picasso sculpture by going for \$6.7 million at Christie's in November. And, although one-third of the 21 works in the Weisel sale at Sotheby's in November failed to sell, the best piece soared in price. *Orestes*, an early Willem de Kooning, went for an astonishing \$13.2 million.

Some collectors are paying top dollar for works they really want. At the fall auctions, Broad anted up \$2.6 million for

Alexander Calder mobile, \$1,000 for a 1984 black and white painting from Andy Warhol's Rorschach series, double the price three years ago, and \$1 million for a large oil painting titled *Willes and the Tortoise* by 70-year-old U.S. artist Mark Tansey (four times the previous record for a Tansey). Among the paintings Grothe sold last year and late in 2001 for a total of \$23 million was a rare early work by Gerhard Richter, a 70-year-old German artist, that fetched \$9 million, according to German press reports. The confirms the buyer was French financier François Pinault, owner of Christie's. More affordable works take some time to find.



PICASSO'S BODACIOUS BABOON:

This bronze sold for \$6.7 million at Christie's in November, a world record for a sculpture by the master

Top works command high prices in any market: Rubens' *Massacre of the Innocents*, found in an Austrian monastery, went for \$76.7 million



Collectors may want to focus on out-of-the-box areas, such as 18th century English, French, and American paintings, Grothe says. New York dealer Debra Broad points to 19th century American water colors, which can be had for as little as a few thousand dollars. Whatever your taste, it pays to scout the auction houses' day after day, where prices are generally more modest. Boston money manager Scott

Black, who was outbid on several million-dollar Impressionist works in the evening sales, nabbed a \$202,000 portrait by Camille Pissarro at a day sale. Broad snapped up a 1977 painting by Leon Golub, the 80-year-old Chicago-born artist, for \$5,378, half the pre-auction estimate.

Another tactic is to focus on markets that are just gaining attention. In January, Christie's plans to hold the first major auction of so-called outsider works

by self-taught artists, such as James Castle, an Idaho man who died in 1977. *Untitled (Bird)*, one of his delicate string and paper constructions, is expected to sell for \$12,000 to \$18,000.

Video art, which is shown on TV monitors, is another

promising area. Pioneering video collectors, such as San Francisco venture capitalist Richard Kramlich and his wife, Pamela, have already seen the value of their collections soar. Now, video art is showing up

at major auctions, and the Kramlichs say their mainstream collector friends, such as Helen and Charles Schwab, are buying. Among the up-and-comers the Kramlichs recommend are London's Darren Almond, 31, whose videos, sculptures, and paintings sell for \$5,000 to \$25,000, and twentysomething New Yorker Slater Bradley, whose videos start below \$10,000.

A good tactic for discovering new artists is to track the ones taken up by savvy dealers such as Marian Goodman in New York and Victoria Miro in London. Collectors are already lining up to buy works by artists Miro plans to feature in 2003, such as Verne Dawson, 41, and Tal R, an Israeli-born Dane. Prices range from \$10,000 to \$35,000.

Whatever art you buy, hold onto it. Research at New York University indicates that long-term investments in art appreciate almost as much as stocks—and are relatively impervious to economic downturns, sagging stock markets, and even war. But that only holds true if you amortize dealer and auction house fees—typically one-third or more of a work's price—over many years. Plus, if veteran collectors are correct, the market could be taking a hit anytime now. ■



VIDEO VISION:

Pamela and Richard Kramlich are in the forefront of collecting video art pieces

BusinessWeek online

For a Q&A with art collector Eli Broad, go to www.businessweek.com.



How to Find Nuggets

Stock screens can help. **BY ROBERT J. ROSENBERG**

PANNING FOR QUALITY COMPANIES is hard work, no doubt about it. That's where *BusinessWeek's* Investment Outlook Scoreboard comes in. Made up of America's 900 top companies, grouped into 10 broad sectors, the Scoreboard offers a river of information. To help you find the real nuggets, we pre-screen the list using several classic stock-picking methods. And find them we do. Our cheap stocks rose 14.2% in a tough 2002. Even allowing for

disaster areas such as tech, our six list lost an average of just 1.1%—best of the Dow Jones industrial average, the Standard & Poor's 500-stock index, and most equity mutual funds.

This year, dividends could be a major investing theme. With the White House leaning toward easing double taxation on payouts, dividend-paying stocks might have a sharp run-up. Our list of high-yield, large-cap stocks, whose yields exceed that of 10-year Treasuries, currently about 4%, is the place to start. Tobacco companies Philip Morris Inc. and UST Inc. top the list, followed closely by J.P. Morgan Chase & Co. and FleetBoston Financial Corp. UST, a maker of chewing tobacco, announced that profits would rise only 2.1% in 2003. Merrill Lynch & Co. says that rising cigarette prices most likely will drive smokers toward UST's smokeless brand.

UTILITY VALUE

Data on price-earnings ratios, dividend yields, and price-cash-flow ratios were provided by Standard & Poor's COMPUSTAT. Thomson Financial/First Call provided earnings estimates and projected long-term growth rates.

As you might guess, utilities dominated our screen of stocks having an S&P rating of A- or better that trade at a discount to book value. That's no surprise: They have high book value because of their hefty investments in plants. And with the industry distressed in the wake of the Enron scandal, utility shares sell at a discount. More surprising is the presence of retailers I. Lard's Inc. and Longs Drug Stores Co. The good news at Longs is that over sales and same-store sales are up. Dillard's, things are less promising: November sales were down, but the comparison is complicated by the late start this year to the holiday shopping season.

The past three years have not been kind to tech or momentum investors, but avoiding these areas risks missing big gains, since they represent the most innovative sector of the economy. I came up with a tech momentum list screening tech companies for their estimated growth in earnings per share and year-to-date share price change. Topping the list is personal-finance software maker Intuit Inc. Its revenues soared 32% year-over-year, to \$223.3 million in its fiscal first quarter, and the company reiterated that it expects pro forma earnings to be up 37% to 42% in fiscal 2003. The key to Intuit's success: New products and a focus on individual and small business. Bryan C. Kea

who covers Intuit for Prudential Securities, says the company will outperform the market.

Our high-growth tech list is dominated by chipmakers, especially the likes of Linear Technology and Texas Instruments, which design and make the analog chips that go into cell phones, MP3 players, and personal digital assistants. Electronic Arts Inc., the No. 1 game-software maker, made both of our tech lists. Its sales rose 88.8% in the second quarter of fiscal '03. Hit products, such as The Lord of the Rings: The Two Towers and James Bond 007: NightFire, are driving the results, says WR Hambrecht's William Pennan, who rates EA a buy.

Bargain hunters will want to comb through our list of cheap stocks. Last

year, CompuCom Systems Inc. was the big winner, with a 219% rise. But this year, the list is strictly for investors with nerves of steel. Four companies on it—Reliant Resources, Allegheny Energy, TXU, and AES—are utilities. They're cheap because their shares plummeted nearly 76%, on average, in 2002.

DON'T GET BURNED

Clearly, caution is needed: The utilities sector is the weakest in the S&P, says Merrill Lynch's Richard Bernstein. Unregulated multiline utilities such as AES and Reliant Resources are the stocks that analysts are downgrading the most aggressively. If the utilities remain solvent, then their stocks might turn out to be bargains. But watchful folks can sidestep them. R.J. Reynolds Tobacco Hold-

ings Inc. is cheap and also pays a handsome dividend, which analysts say will probably rise in 2003.

Value investors should look at our low price-to-sales, low price-to-cash-flow screen. We added cash-flow data to the mix this year to test companies' ability to meet obligations. Two auto-parts makers, Visteon Corp. and Tenneco Automotive Inc., ended in the top 10. John A. Casesa, an auto analyst at Merrill, is recommending investors look at auto suppliers because they are more profitable and are cheaper than the auto makers. Visteon, part of Ford Motor Co. until being spun off in 2000, says it will gain about \$500 million in non-Ford business in 2003.

So get out the pickaxes, and start digging. Amid the data lies gold. ■

A MENU OF INVESTMENT OPPORTUNITIES

Examined the Scoreboard using several screens. Be careful, though: Unusually high or low results may also be a sign of trouble.

HIGH-GROWTH TECH STOCKS

Technology companies projected to have higher-than-average long-term earnings growth

	PRICE CHANGE DEC. 31, 2001- NOV. 29, 2002	LONG-TERM EARNINGS GROWTH	S&P EQUITY RANKING
INTUIT TECHNOLOGY LLC	-15%	25.0	A
ELECTRONIC ARTS ERTS	13	25.0	B+
INTEGRATED PRODS. MXM	-20	25.0	B+
CIRCUIT JBL	-6	25.0	B
3M INTEGRATED COMPUTER SVCS. ACS	-6	20.0	B+
TECHNICAL SYSTEMS CSCO	-18	20.0	B+
3M HARD DATA SYSTEMS SDS	-19	20.0	B+
TECHNICAL INSTRUMENTS TXN	-29	20.0	B+
3M PERSE TECHNOLOGY CMT	-46	18.8	B+
3M INTC	-34	18.0	A

HIGH HOPES FOR TECH EARNINGS

These technology companies' earnings are forecast to move ahead strongly in 2003

	PRICE CHANGE DEC. 31, 2001- NOV. 29, 2002	PERCENT CHANGE EARNINGS 2002-2003
INTUIT INTU	26%	325%
JABIL CIRCUIT JBL	-6	324
WESTERN DIGITAL WDC	35	57
YAHOO! YHOO	3	56
BMC SOFTWARE BMC	9	39
STORAGE TECHNOLOGY STK	7	26
ELECTRONIC ARTS ERTS	13	25
DELL COMPUTER DELL	5	23
COMPUCOM SYSTEMS CMPC	189	14
BENCHMARK ELECTRONICS BHE	64	13

BIG CAPS WITH THE HIGHEST DIVIDENDS

Minimum market cap of \$5 billion, excludes utilities and REITs

COMPANY/SYMBOL	YIELD
PHILIP MORRIS MO	6.8%
UST UST	6.0
J.P. MORGAN CHASE JPM	5.4
FLEETBOSTON FINANCIAL FBF	5.2
GENERAL MOTORS GM	5.0
EASTMAN KODAK EK	4.9
AMSOUTH BANCORP. ASO	4.8
H.J. HEINZ HNZ	4.7
MARATHON OIL MRO	4.6
KEYCORP KEY	4.6

BARGAIN STOCKS WITH CASH

Companies with both low price-to-sales and low price-to-cash-flow ratios

	PRICE-TO- SALES RATIO	PRICE-TO- CASH-FLOW RATIO
RELIA T RESOURCES RRI	0.05	0.9
MARK STORES PTMK	0.03	1.2
WESTERN NOR	0.10	1.3
ALLEGHENY ENERGY AYE	0.08	1.4
NASH FINCH NAFCE	0.02	1.4
NVC	0.06	1.9
AT MIR	0.03	2.1
ING FLM	0.03	2.5
CO AUTOMOTIVE TEN	0.05	2.5
GROUP OMG	0.04	2.8

LOW PRICE-TO-BOOK STOCKS

Companies with an S&P Equity Ranking of at least A-

COMPANY/SYMBOL	PRICE AS PERCENT OF BOOK VALUE	S&P EQUITY RANKING
OM GROUP OMG	26%	A
ALLEGHENY ENERGY AYE	34	A-
NORTHWESTERN NOR	73	A
DILLARD'S DDS	75	A-
ONEOK OKE	85	A-
PINNACLE WEST CAPITAL PNW	102	A
ROYAL CARIBBEAN CRUISES RCL	104	A
IDACORP IDA	104	A-
LONGS DRUG STORES LDG	109	A-
CINCINNATI FINANCIAL CINF	113	A-

CHEAP STOCKS

Companies with both low price-to-book and low price-earnings ratios

COMPANY/ SYMBOL	PRICE AS PERCENT OF BOOK VALUE	P-E RATIO
RELIA T RESOURCES RRI	11%	2
ALLEGHENY ENERGY AYE	34	3
HEALTHSOUTH HRC	41	6
AES AES	44	7
R.J. REYNOLDS TOBACCO RJR	46	6
NASH FINCH NAFCE	46	4
KINDRED HEALTHCARE KIND	47	7
AMERICREDIT ACF	48	2
TXU TXU	49	5
UNITED RENTALS URI	49	7

Data: Thomson Financial/First Call, Standard & Poor's COMPUSTAT

Nov. 29. All other data as of Dec. 5

2003

Investment Outlook Scoreboard

Glossary

MARKET VALUE: Share price on Nov. 29, 2002, multiplied by the latest available common shares outstanding.

RECENT SHARE PRICE: Price for a single share of a company's most widely traded issue of common stock as of the close of trading Nov. 29, 2002.

PRICE CHANGE: Percentage change in the company's most widely traded common-stock issue since Dec. 31, 2001.

EARNINGS GROWTH: Compound annual growth rate, calculated using the 1997 and 2001 restated basic earnings per share (unless noted otherwise).

RETURN ON EQUITY: The latest available net income available for shareholders divided by total equity.

PRICE AS PERCENTAGE OF BOOK VALUE

VALUE: Share price on Nov. 29, 2002, as a percentage of the latest available book value per share, which is the sum of common stock at nominal balance-sheet value, capital surplus, and retained earnings as shown in company accounts divided by the number of shares outstanding.

P-E RATIO: Price-earnings ratio based on the latest available 12 months earnings and Nov. 29, 2002, stock price.

PRICE-SALES RATIO: Based on the latest available 12 months sales and the Nov. 29, 2002, stock price.

PRICE-CASH FLOW RATIO: The Nov. 29, 2002 stock price divided by the latest available 12 months cash flow. Cash flow is equal to income from continuing operations before extraordinary items plus depreciation and amortization.

PRICE-EARNINGS TO GROWTH RATE

The price-earnings ratio based on the 2002 earnings estimate and Nov. 29, 2002, stock price, divided by the long-term earnings growth rate.

DIVIDEND YIELD: Indicated annual dividend as a percent of the Nov. 29, 2002, stock price.

EARNINGS PER SHARE: Diluted earnings per share—net income (including proceeds from certain convertible securities, warrants, and options that are common-stock equivalents, but

excluding extraordinary profits or losses) divided by number of common and common equivalent shares.

EARNINGS PER SHARE ESTIMATES: Analysts' consensus estimates for 2002 and 2003 compiled by Thomson Financial/First Call.

LONG-TERM EARNINGS GROWTH: The median estimate by analysts of the annual growth rate of earnings compiled by Thomson Financial/First Call. For most companies, this is for the next 3-5 years.

S&P EQUITY RANKING: A measure of a company's historical growth of earnings and dividends, using Standard & Poor's computerized scoring system based on the most recent 10 years of earnings per share and dividends.

EARNINGS PER SHARE

COMPANY STOCK SYMBOL (FY)	MARKET VALUE	RECENT SHARE PRICE	2002 PRICE CHANGE %	EARNINGS GROWTH 1997-2001 %	RETURN ON EQUITY	PRICE AS % OF BOOK VALUE	P-E RATIO	PRICE-SALES RATIO	PRICE-CASH FLOW RATIO	P-E TO GROWTH RATE	YIELD %	ESTIMATES FROM ANALYSTS				S&P EQUITY RANKING
												2001 ACTUAL	2002 ANALYST EST.	CONSENSUS	LONG-TERM GROWTH RATE %	
ALL-INDUSTRY AVERAGE	10502.5	111	-10	9.9	11.2	283	30	1.4	13.1	2.0	1.44	1.54	4.63	5.51	12.9	
CONSUMER DISCRETIONARY																
SECTOR AVERAGE	7212.9	33	-3	15.6	13.9	288	25	1.1	12.6	1.7	0.74	1.21	2.14	2.47	14.4	
1 AUTOMOBILES & COMPONENTS																
INDUSTRY GROUP AVERAGE	4634.8	25	-4	-8.4	-2.2	175	22	0.4	7.9	4.8	1.63	-0.06	2.29	2.49	11.3	
(A) AUTO COMPONENTS																
INDUSTRY AVERAGE	2109.2	23	-9	-14.5	-2.7	136	22	0.2	7.3	5.5	1.48	-0.16	2.20	2.48	11.1	
AMERICAN AXLE & MFG. HOLOINGS AXL	1196.6	24	12	36.2	22.4	173	8	0.4	4.1	0.7	0.00	2.36	3.21	3.41	10.0	N
ARVINMERITOR ARM (9)	1118.3	16	-16	-42.9a,b	20.1	151	7	0.2	3.2	0.7	2.43	0.53	2.22*	2.48	10.0	NR
AUTOLIV ALV	2128.8	22	9	NM	8.0	107	14	0.5	5.2	0.5	1.99	0.49	1.82	1.95	26.0	N
BORGWARNER BWA	1385.3	52	-1	-12.8	11.3	141	12	0.5	6.1	0.8	1.16	2.51	5.55	6.22	12.0	B+
COLLINS & AIKMAN CKC	342.8	4	-79	NM	-16.7	72	NM	0.1	46.5	NM	0.00	-1.28	-0.22	0.30	15.0	N
COOPER TIRE & RUBBER CTB	1169.5	16	0	-36.6	10.5	118	11	0.4	4.1	0.9	2.64	0.25	1.49	1.62	12.0	B+
DANA DCN	2005.6	14	-3	NM	-15.0	120	NM	0.2	8.1	1.2	0.30	-2.01	1.17	1.40	10.0	B
OELPHI DPH	4746.4	9	-38	NM	3.9	202	50	0.2	4.3	0.9	3.29	-0.66	0.91	0.95	10.0	NR
OURA AUTOMOTIVE SYSTEMS DRRA	176.4	10	-12	-24.0	0.7	37	69	0.1	2.4	0.4	0.00	0.62	2.52	2.80	10.0	N
GOODYEAR TIRE & RUBBER GT	1444.5	8	-65	NM	-6.0	50	NM	0.1	3.3	68.1	5.83	-1.27	0.02	0.25	5.5	B
JOHNSON CONTROLS JCI (9)	7358.0	83	3	14.7	17.7	252	13	0.4	6.6	1.0	1.74	5.11	6.35*	7.11	13.5	A+
LEAR LEA	2411.9	37	-4	-35.9	9.7	161	17	0.2	5.2	0.8	0.00	0.52	4.52	5.03	10.0	NR
TENNECO AUTOMOTIVE TEN	165.1	4	102	NM	-72.6	156	NM	0.0	2.5	1.0	0.00	-3.43	0.58	0.80	7.0	C
TOWER AUTOMOTIVE TWR	355.4	6	-37	NM	-54.5	65	NM	0.1	NM	0.6	0.00	-5.87	1.00	0.92	10.0	NR
TRW TRW	6696.0	52	40	NM	19.3	334	17	0.4	6.4	1.5	1.35	0.54	3.56	4.01	10.0	B
VISTEON VC	1046.5	8	-46	NM	-2.2	34	NM	0.1	1.9	2.8	2.98	-0.91	0.47	0.34	6.0	N
(B) AUTOMOBILES																
INDUSTRY AVERAGE	14737.2	34	12	5.7	-0.1	331	21	1.1	9.8	2.2	2.24	0.32	2.68	2.57	12.0	
FORD MOTOR F	20883.5	11	-28	NM	-49.5	209	NM	0.1	2.0	5.0	3.51	-3.02	0.45	0.50	5.0	B
GENERAL MOTORS GM	22285.1	40	-18	-32.4	5.0	116	18	0.1	1.6	1.2	5.04	1.77	6.52	5.03	5.0	B
HARLEY-DAVISON HDI	14690.7	49	-11	25.7	25.7	690	27	3.5	20.4	1.4	0.29	1.43	1.87	2.22	18.0	A
THOR INDUSTRIES THO (7)	1089.4	38	106	23.8	18.4	307	17	0.8	15.3	1.0	0.10	1.11	1.87*	2.53	20.0	A

FOOTNOTES: *Actual, not estimated data. NA=not available. NM=not meaningful. NR=not ranked. (a) Four-year compound growth rate. (b) Final year of growth rate calculation is 2001. (c) Pro forma data. Data compiled by COMPUSTAT from sources such as statistical services, registration statements, and company reports that COMPUSTAT believes to be reliable but is not guaranteed by COMPUSTAT or BusinessWeek as to correctness or completeness. This material is not an offer to buy or sell any security. Additional data: Thomson Financial/First Call.

EARNINGS PER SHARE

												ESTIMATES FROM ANALYSTS				
COMPANY STOCK SYMBOL (FY)	MARKET VALUE	RECENT SHARE PRICE	2002 PRICE CHANGE %	EARNINGS GROWTH 1997-2001 %	RETURN ON EQUITY	PRICE AS % OF BOOK VALUE	P-E RATIO	PRICE-SALES RATIO	PRICE-CASH FLOW RATIO	P-E TO GROWTH RATE	YIELD %	2001 ACTUAL	2002 ANALYST EST.	CON-SENSUS	LONG-TERM GROWTH RATE %	S&P EQUITY RANKING
CONSUMER DURABLES & APPAREL																
INDUSTRY GROUP AVERAGE	2896.6	40	4	21.1	18.1	270	26	0.7	10.0	1.1	1.05	2.58	3.85	4.37	12.6	
(A) HOUSEHOLD DURABLES																
INDUSTRY AVERAGE	2446.1	45	3	25.4	20.3	275	16	0.6	9.5	0.9	0.94	3.22	4.74	5.38	13.2	
AMERICAN GREETINGS AM (2)	1071.2	16	18	NM	2.3	110	63	0.5	11.0	1.2	0.00	-1.92	1.53	1.68	8.5	C
BEAVER HOMES USA BZH (9)	817.7	64	-13	37.4	15.3	102	6	0.3	6.2	0.4	0.00	8.26	10.74*	12.11	15.0	B+
BLACK & DECKER BDK	3461.0	43	14	-13.6	15.3	377	25	0.8	12.7	0.9	1.12	1.33	3.19	3.60	14.5	B-
LYTH BTH (1)	1283.0	28	19	6.9	15.6	250	16	1.0	11.7	1.3	0.79	1.44	2.01	2.16	11.0	NR
ENTEX CTX (3)	3014.3	50	-12	26.7	18.1	131	8	0.4	5.9	0.4	0.32	6.11	8.09	9.21	15.0	A
CHAMPION ENTERPRISES CH8	179.4	4	-70	NM	NM	690	NM	0.1	NM	NM	0.00	-0.59	-0.77	0.13	NA	C
CLAYTON HOMES CMH (6)	1832.3	13	-21	-0.8	10.0	144	15	1.5	12.5	1.0	0.47	0.77	0.89*	0.97	15.0	A-
DEETWOOD ENTERPRISES FLE (4)	294.9	8	-27	NM	-40.2	166	NM	0.1	NM	NM	0.00	-1.53	-0.15	0.42	NA	C
FURNITURE BRANDS FO	7279.0	49	23	80.5	22.2	310	14	1.3	10.3	1.4	2.21	2.49	3.19	3.55	11.0	B-
FURNITURE BRANDS INTL. FBN	1557.8	28	-13	-0.9	13.0	180	14	0.7	9.8	0.8	0.00	1.13	2.10	2.65	16.0	NR
ARMAN INTERNATIONAL INDS. HAR (6)	2013.6	62	38	5.3	11.9	384	34	1.1	14.2	1.9	0.16	0.96	1.70*	2.97	19.5	B+
JORTON (D.R.) OHI (9)	2798.6	19	-12	32.9	17.8	123	7	0.4	7.2	0.4	1.26	2.21	2.87*	3.38	15.0	A-
JOVNIANIAN ENTERPRISES HOV (10)	1020.5	33	57	NM	24.6	181	8	0.4	7.0	0.7	0.00	2.29	4.30*	4.67	11.5	8
LE HOME KBH (11)	1786.1	45	11	39.7	24.7	158	7	0.4	5.9	0.5	0.67	5.50	6.82	7.59	12.0	8+
LE-Z-BOY LZ8 (4)	1426.4	25	15	2.3	15.6	235	16	0.6	10.8	0.9	1.59	1.01	1.79	2.05	15.0	A
LEGGETT & PLATT LEG	4645.7	24	4	-3.6	11.2	237	22	1.1	11.8	1.4	2.18	0.94	1.16	1.42	15.0	A-
LENNAR LEN (11)	3434.4	53	13	49.0	24.2	172	8	0.5	6.5	0.6	0.09	6.01	7.36	8.10	12.5	A-
M.D.C. HOLDINGS MDC	951.4	36	-6	51.1	20.8	126	6	0.4	5.2	0.5	0.90	5.72	5.89	6.38	13.0	A-
MYTAG MYG	2416.1	31	0	4.3	101.2	1157	11	0.5	NA	0.8	2.33	2.13	2.94	3.03	12.5	8+
SHAWK INDUSTRIES MHK	4094.0	62	12	28.3	13.7	216	15	1.0	11.5	1.0	0.00	3.55	4.31	4.84	15.0	8
WELL RUBBERMAID NWL	8478.8	32	15	-3.7	14.0	414	29	1.2	14.6	1.7	2.65	0.99	1.57	1.80	12.0	A-
R NVR	2346.5	331	62	87.1	89.6	658	10	0.8	7.1	0.6	0.00	24.86	36.03	40.27	15.0	NR
LTE HOMES PHM	2873.0	47	5	52.5	15.1	111	7	0.4	NA	0.6	0.34	6.01	7.07	7.89	11.4	8+
LAND GROUP RYL	965.8	38	3	66.5	25.8	153	6	0.3	4.9	0.5	0.21	4.79	6.09	6.73	12.5	8
AP-ON SNA	1748.6	30	-11	-37.8	6.2	206	33	0.8	16.2	1.7	3.34	0.37	1.80	2.05	10.0	B+
STANDARD PACIFIC SPF	835.5	26	5	45.8	13.2	113	8	0.5	8.3	0.5	1.25	3.63	3.58	4.09	13.0	NR
WINLEY WORKS SWK	3172.3	36	-23	NM	17.8	326	18	1.2	13.0	1.1	2.84	1.81	2.46	2.79	13.0	8
ALL BROTHERS TOL (10)	1472.0	21	-4	27.7	19.5	130	7	0.6	6.4	0.6	0.00	2.76	2.91*	3.23	13.0	B+
WHIRLPOOL WHR	3667.7	54	-27	NM	30.9	419	14	0.3	5.6	1.0	2.53	0.50	6.06	6.25	8.5	B
LEISURE EQUIPMENT & PRODUCTS																
INDUSTRY AVERAGE	5067.9	31	7	23.6	17.0	341	24	1.0	9.8	1.7	2.03	1.23	1.97	2.27	11.0	
UNSWICK 8C	1894.5	21	-3	-3.8	6.5	153	24	0.5	8.1	1.9	2.38	0.96	1.12	1.50	10.0	B-
STMAN KODAK EK	10743.7	37	25	125.8	13.3	317	24	0.8	8.4	2.1	4.88	0.26	2.70	2.80	6.5	B
SBRO HAS	2220.0	13	-21	-15.9	5.7	195	35	0.8	8.3	2.0	0.94	0.35	0.58	0.89	11.0	8
TTTEL MAT	9008.9	21	20	-1.3	22.2	492	23	1.9	14.7	1.6	0.24	0.71	1.05	1.20	12.3	8+
PARIS INDUSTRIES PII	1472.5	65	12	13.0	37.4	549	15	1.0	9.5	1.0	1.73	3.88	4.38	4.97	15.0	A-
TEXTILES, APPAREL & LUXURY GOODS																
INDUSTRY AVERAGE	3117.5	30	6	7.4	12.4	221	57	0.8	11.5	1.1	0.90	1.37	2.19	2.49	12.1	
ES APPAREL GROUP JNY	4747.2	37	11	13.2	13.7	208	16	1.1	11.8	1.0	0.00	1.82	2.80	3.07	13.0	8+
WALWOOD KWD (1)	727.7	28	19	-3.6	5.5	131	24	0.3	13.5	1.4	2.25	1.65	2.05	2.55	10.0	8+
CLAIBORNE LIZ	3434.2	32	29	8.7	17.5	279	16	1.0	10.9	1.2	0.70	1.83	2.19	2.51	12.0	A-
LE NKE (5)	11880.1	45	-20	16.0	18.5	323	18	1.2	13.1	1.1	1.25	2.46	2.79	3.15	14.8	A
CLIPS-VAN HEUSEN PVH (1)	365.3	13	21	NM	5.3	127	24	0.3	10.0	1.3	1.14	0.38	1.06	1.16	10.0	B
DO RALPH LAUREN RL (3)	2344.7	24	-11	24.8a	14.4	222	16	1.0	10.1	1.1	0.00	1.75	1.86	2.11	12.0	NR
BOK INTERNATIONAL R8K	1717.4	29	8	-7.7	14.2	203	15	0.6	11.3	1.0	0.00	1.66	2.03	2.28	13.9	B-
SELL RML	512.8	16	6	NM	0.4	108	399	0.4	11.1	0.9	1.00	-1.74	1.54	1.68	12.0	B-
BERLAND T8L	1347.7	37	-2	27.0	25.2	364	15	1.1	11.6	1.1	0.00	2.65	2.25	2.68	14.2	B
WFC	4098.4	38	-3	-19.0	9.9	241	24	0.8	NA	1.3	2.64	1.19	3.36	3.68	9.0	B+
HOTELS RESTAURANTS & LEISURE																
INDUSTRY GROUP AVERAGE	5713.6	27	-1	9.1	17.2	289	22	1.3	10.3	1.2	0.62	1.10	1.62	1.86	14.7	
BANKER INTERNATIONAL EAT (6)	2886.6	30	0	22.2	15.8	288	19	1.0	9.7	1.2	0.00	1.42	1.52*	1.90	16.0	B+
UNIVAL CCL (11)	16459.0	28	0	9.0	12.9	226	18	3.8	12.5	1.3	1.50	1.58	1.70	2.07	13.0	A+
EL GROUP CBRL (7)	1352.7	27	-7	0.1	12.0	171	16	0.6	8.5	1.1	0.07	0.87	1.64*	1.93	15.0	8+
RESTAURANTS CKR (1)	285.3	5	-45	NM	12.8	142	12	0.2	3.4	0.4	0.00	-1.66	0.51	0.67	22.5	C
EDEN RESTAURANTS ORI (5)	3696.5	22	-8	31.1	21.2	317	16	0.8	8.8	1.0	0.37	1.30	1.46	1.66	15.0	NR
GRAH'S ENTERTAINMENT HET	4471.0	40	8	14.5	21.9	299	14	1.1	6.9	0.9	0.00	1.81	3.00	3.23	15.0	B-
TON HOTELS HLT	5151.5	14	25	-9.8	8.0	255	32	1.5	10.0	1.8	0.58	0.45	0.51	0.55	15.0	B
EL GAME TECHNOLOGY IGT (9)	6733.6	78	14	24.8	19.3	470	24	3.6	22.5	1.6	0.00	2.80	3.21*	3.91	15.0	B+
EX IN THE BOX J8X (9)	786.8	20	-27	3.8	17.9	170	10	0.4	NA	0.8	0.00	2.11	2.07*	2.36	12.0	B-
INDALAY RESORT GROUP M8G (1)	1903.4	28	29	-6.4	6.3	185	30	0.8	7.8	1.0	0.00	0.71	1.94	2.26	15.0	B-
MARRIOTT INTERNATIONAL MAR	8500.3	36	-12	-6.5	5.3	226	48	0.8	21.2	1.3	0.78	0.92	1.83	2.05	15.0	NR
WALDON'S MCO	23482.1	19	-30	2.1	15.0	221	15	1.5	8.8	1.3	1.27	1.25	1.39	1.48	10.0	A+
WAL MIRAGE MGG	5375.3	34	17	1.5	10.1	195	20	1.4	8.0	1.1	0.00	1.06	2.03	2.17	15.0	B

COMPANY	STOCK SYMBOL (FY)	MARKET VALUE	RECENT SHARE PRICE	2002 PRICE CHANGE %	EARNINGS GROWTH 1997-2001 %	RETURN ON EQUITY	PRICE AS % OF BOOK VALUE	P-E RATIO	PRICE-SALES RATIO	PRICE-CASH FLOW RATIO	P-E TO GROWTH RATE	YIELD %	ESTIMATES FROM ANALYSTS				S&P EQUITY RANK
													2001 ACTUAL	2002 ANALYST EST.	CONSENSUS	LONG-TERM GROWTH RATE %	
OUTBACK STEAKHOUSE	OSI	2699.1	36	4	19.3	14.9	263	18	1.2	11.9	1.1	1.35	1.70	2.07	2.36	15.0	8+
PARK PLACE ENTERTAINMENT	PPE	2489.0	8	-10	NM	5.4	84	16	0.5	3.8	1.6	0.00	-0.08	0.52	0.59	10.0	NR
ROYAL CARIBBEAN CRUISES	RCL	4162.1	22	34	2.0	6.8	104	15	1.3	6.8	1.1	2.40	1.32	1.63	2.05	12.0	A
STARBUCKS	SBUX (9)	8483.3	22	14	27.8b	12.5	491	40	2.6	20.2	1.9	0.00	0.46	0.54*	0.66	21.5	8+
STARWOOD HOTELS & RESORTS	HOT	5052.4	25	-15	NM	2.6	125	50	1.3	8.7	1.8	3.16	0.73	0.97	1.12	15.0	NR
WENDY'S INTERNATIONAL	WEN	3224.2	28	-4	14.8	14.9	224	15	1.2	9.3	1.1	0.86	1.65	1.91	2.13	13.8	A-
YUM! BRANDS	YUM	7077.4	24	-3	4.8a	107.9	1328	13	0.9	7.6	1.0	0.00	1.62	1.90	2.06	12.8	NR
4 MEDIA																	
INDUSTRY GROUP AVERAGE		15229.3	57	-17	7.3	13.5	452	37	2.4	21.7	2.2	0.64	0.97	1.57	2.02	14.3	
AMC ENTERTAINMENT	AEN (3)	357.6	10	-18	NM	-17.5	117	NM	0.2	3.9	NM	0.00	-1.73	-0.87	-0.41	7.0	8-
AOL TIME WARNER	AOL	73128.1	16	-49	NM	-1.5	75	NM	1.8	NA	1.4	0.00	-1.11	0.87	0.84	13.4	8-
BELO	BLIC	2605.2	23	24	NM	5.9	185	31	1.9	12.5	1.9	1.29	-0.02	1.08	1.16	11.0	8+
CABLEVISION SYSTEMS	CVC	5105.1	17	-64	NA	NM	NM	NM	1.2	19.4	NM	0.00	3.76	-1.78	-1.20	14.0	8
CHARTER COMMUNICATIONS	CHTR	601.2	2	-88	NA	-41.1	27	NM	0.1	0.4	NM	0.00	-4.28	-2.52	-2.16	11.5	NR
CLEAR CHANNEL COMMUNICATIONS	CCU	26629.2	43	-15	NM	1.3	190	161	3.3	24.1	2.2	0.00	-1.93	1.11	1.29	18.0	C
COX COMMUNICATIONS	COX	18777.2	30	-28	NM	-5.9	199	NM	3.9	22.8	NM	0.00	0.06	-0.76	-0.01	12.0	NR
DISNEY (WALT)	DIS (9)	39877.8	20	-4	-9.9	5.5	170	32	1.6	17.5	2.5	1.06	0.11	0.60*	0.68	13.0	8
DOW JONES	DJ	3417.8	41	-24	NM	327.6	5127	16	2.1	10.4	6.7	2.41	1.14	0.56	0.94	11.0	8
ECHOSTAR COMMUNICATIONS	DISH	9812.6	20	-26	NM	-59.1	NM	NM	2.1	68.9	NM	0.00	-0.45	-0.51	0.69	30.0	C
FOX ENTERTAINMENT GROUP	FOX (6)	22659.3	27	0	22.5	6.6	184	27	2.3	19.5	2.7	0.00	0.28	0.72*	0.90	13.5	NR
GANNETT	GCI	19043.1	71	6	6.8	16.3	292	18	3.0	14.2	1.7	1.35	3.12	4.31	4.64	10.0	A
HUGHES ELECTRONICS	GMH	15536.7	12	-24	NA	-5.1	163	NM	1.8	24.7	NM	0.00	-0.54	-0.33	-0.06	35.0	C
INTERPUBLIC GROUP	IPG	5764.9	15	-49	NM	13.4	266	19	0.9	NA	1.7	2.54	-1.37	0.73	0.99	12.0	A
KNIGHT-RIDDER	KRI	5160.8	63	-3	-14.7	17.0	337	21	1.8	12.9	1.9	1.72	2.16	3.44	3.84	9.8	A-
LIBERTY MEDIA	L	27352.2	11	-25	NA	-27.1	113	NM	13.2	NM	NM	0.00	-2.61	-1.18	-0.50	15.0	NR
McGRAW-HILL	MHP	11490.4	59	-3	7.5	20.2	529	26	2.4	19.7	1.7	1.72	1.92	††	††	††	NR
††Because BusinessWeek is owned by The McGraw-Hill Companies, the Scoreboard does not include forecasts of the company's earnings.																	
METRO-GOLDWYN-MAYER	MGM	3552.2	14	-35	NM	-6.6	144	NM	2.5	NM	NM	0.00	-0.24	-0.74	0.07	10.0	N
NEW YORK TIMES	NYT	7273.4	48	11	0.8	21.1	576	28	2.4	16.9	2.1	1.12	1.26	1.95	2.23	12.0	8+
OMNICOM GROUP	OMC	12797.8	68	-24	20.6	26.3	554	21	1.7	15.3	1.3	1.18	2.70	3.43	3.73	15.0	A+
PRIMEOIA	PRM	878.7	3	-22	NM	NM	NM	NM	0.5	NM	NM	0.00	-5.42	-0.43	-0.33	11.0	NR
READER'S DIGEST ASSOCIATION	RDA (6)	1717.4	17	-26	54.0	18.8	388	20	0.7	NA	1.6	1.17	1.26	0.89*	1.28	12.0	8
SCHOLASTIC	SCHL (5)	1740.3	44	-12	38.6	12.7	258	21	0.9	13.9	1.1	0.00	2.51	2.73	3.26	15.0	8
SCRIPPS (E.W.)	SSP	6341.1	79	20	NA	8.3	432	52	4.2	33.0	1.9	0.76	1.73	2.83	3.09	15.0	8+
TMP WORLWIDE	TMPW	1619.7	15	-66	-3.3	-4.6	197	NM	1.4	61.8	1.4	0.00	0.61	0.42	0.43	25.0	NR
TRIBUNE	TRB	13959.4	46	22	-33.6	8.5	250	30	2.6	17.5	2.0	0.96	0.28	1.84	2.09	12.8	A-
VIACOM	VIA.8	82338.0	47	6	NM	2.4	132	55	3.5	27.4	2.6	0.00	-0.13	1.22	1.44	15.0	C
WASHINGTON POST	WPO	6884.5	724	37	-2.1	7.8	395	51	2.7	21.5	3.4	0.77	24.06	21.46	24.29	10.0	A-
5 RETAILING																	
INDUSTRY GROUP AVERAGE		7772.5	24	-3	19.5	15.0	276	23	0.9	13.0	1.4	0.42	0.91	1.53	1.77	16.0	
(A) DISTRIBUTORS																	
INDUSTRY AVERAGE		2025.8	16	-12	77.8	13.7	167	12	0.3	8.3	1.0	1.22	1.18	1.43	1.59	12.7	
GENUINE PARTS	GPC	5552.3	32	-13	-2.6	14.5	266	18	0.7	14.9	1.9	3.65	1.71	2.12	2.29	8.0	A
HANOLEMAN	HDL (4)	297.2	11	-24	243.4	12.5	97	8	0.2	5.1	0.7	0.00	1.39	1.61	1.77	10.0	B-
WESCO INTERNATIONAL	WCC	227.8	5	2	-7.3	14.1	138	10	0.1	5.0	0.5	0.00	0.43	0.56	0.71	20.0	N
(B) INTERNET & CATALOG RETAIL																	
INDUSTRY AVERAGE		8347.4	26	-2	23.0	1.5	404	59	5.0	57.5	3.2	0.00	-0.16	0.47	0.66	27.6	
AMAZON.COM	AMZN	8901.4	23	116	NM	NM	NM	NM	2.5	NM	8.4	0.00	-1.53	0.12	0.24	22.9	N
EBAY	EBAY	19499.5	69	3	24.8	10.4	1069	104	19.1	73.8	2.1	0.00	0.32	0.82	1.16	40.0	N
INSIGHT ENTERPRISES	NSIT	461.6	10	-59	21.2	7.9	102	13	0.2	8.3	0.5	0.00	0.80	1.02	1.13	20.0	N
PRICELINE.COM	PCLN	393.2	2	-70	NM	-10.1	283	NM	0.4	79.6	1.6	0.00	-0.08	0.03	0.05	35.0	N
USA INTERACTIVE	USAI	12481.5	28	2	NM	-2.2	161	NM	2.7	68.4	3.6	0.00	-0.33	0.39	0.71	20.0	B-
(C) MULTILINE RETAIL																	
INDUSTRY AVERAGE		18946.5	27	-7	0.3	12.8	253	27	0.6	11.6	1.3	0.80	1.16	1.70	1.97	13.5	
BIG LOTS	BLI (1)	1474.5	13	22	NM	0.9	154	159	0.4	20.1	1.1	0.00	-0.25	0.66	0.83	17.5	C
BJ'S WHOLESALE CLUB	BJ (1)	1348.4	19	-56	5.8	20.0	194	10	0.2	9.1	0.8	0.00	1.11	1.99	1.91	12.0	N
COSTCO WHOLESALE	COST (8)	14707.0	32	-27	9.5	12.3	258	22	0.4	14.1	1.6	0.00	1.29	1.48*	1.67	14.0	B
DOLLAR GENERAL	DG (1)	1635.8	19	21	-23.9	7.5	75	10	0.2	3.5	1.2	0.83	0.78	2.09	2.37	8.0	A-
DOLLAR TREE STORES	DLTR	4409.5	13	-11	5.9a	21.4	370	17	0.7	11.4	1.1	0.97	0.62	0.75	0.86	15.6	A-
FAMILY DOLLAR STORES	FD (8)	3349.3	29	-5	NA	18.7	437	23	1.5	15.9	1.1	0.00	1.09	1.36	1.63	20.0	B-
FEDERATED DEPARTMENT STORES	FD (1)	5111.5	29	-2	20.4	18.8	443	24	1.2	17.4	1.3	0.88	1.10	1.25*	1.44	18.1	A
KOHL'S	KSS (1)	6410.6	33	-20	-0.8	10.7	113	11	0.4	NA	1.0	0.00	2.59	3.42	3.78	10.0	B
MAY DEPARTMENT STORES	MAY (1)	23069.1	69	-3	33.9	18.5	715	39	2.7	29.6	1.5	0.00	1.45	1.89	2.29	24.0	A
MAY DEPARTMENT STORES	MAY (1)	7050.5	24	-34	1.6	14.5	186	13	0.5	6.1	1.4	3.88	2.22	2.03	2.22	8.8	A
NEIMAN MARCUS GROUP	NMG.A (7)	1498.2	31	1	-0.4	11.1	138	12	0.5	8.2	1.3	0.00	2.26	2.08*	2.67	12.0	
NORSTROM	JWN (1)	2708.6	20	-1	-6.2	7.1	205	28	0.5	8.4	1.7	2.00	0.93	1.17	1.42	10.0	B
PENNEY (J.C.)	JCP (1)	6359.6	24	-12	-31.9	3.9	108	28	0.2	6.7	2.6	2.11	0.32	1.15	1.67	8.0	
SAKS	SKS (1)	1859.8	13	39	NM	2.5	83	34	0.3	6.8	2.0	0.00	-0.11	0.65	0.88	9.9	B
SEARS, ROEBUCK & CO.	S	8792.0	28	-42	-7.2	19.8	141	7	0.2	4.2	0.6	3.32	2.24	4.77	5.30	9.5	

EARNINGS PER SHARE

COMPANY	STOCK SYMBOL (FY)	MARKET VALUE	RECENT SHARE PRICE	2002 PRICE CHANGE %	EARNINGS GROWTH 1997-2001 %	RETURN ON EQUITY	PRICE AS % OF BOOK VALUE	P-E RATIO	PRICE-SALES RATIO	PRICE-CASH FLOW RATIO	P-E TO GROWTH RATE	YIELD %	ESTIMATES FROM ANALYSTS				S&P EQUITY RANKING
													2001 ACTUAL	2002 ANALYST EST.	CONSENSUS	LONG-TERM GROWTH RATE %	
HOPKO STORES	SKO (1)	411.5	14	50	-17.9a	8.4	80	9	0.1	3.2	0.8	0.00	0.98	1.43	1.59	12.0	8
TEIN MART SMRT	(1)	267.0	6	-23	-16.2	9.1	126	14	0.2	NA	0.6	0.00	0.37	0.57	0.69	19.0	8+
TARGET	TGT (1)	31607.1	35	-15	14.0	18.6	361	19	0.7	11.3	1.3	0.69	1.51	1.82	2.08	15.0	A
WAL-MART STORES	WMT (1)	237912.6	54	-6	17.6	20.2	625	31	1.0	21.3	2.2	0.56	1.49	1.79	2.06	14.0	A+
D) SPECIALTY RETAIL																	
INDUSTRY AVERAGE		4299.9	24	-2	22.4	16.7	280	21	0.7	10.2	1.2	0.29	0.90	1.58	1.81	16.0	
BERCROMBIE & FITCH	ANF (1)	2428.0	25	-6	37.9	27.7	371	14	1.6	NA	0.8	0.00	1.65	1.81	2.08	16.8	B
DVANCE AUTO PARTS	AAP	1839.6	52	4	-8.9	10.8	403	42	0.6	NA	0.8	0.00	0.59	2.64	3.30	25.0	NR
AMERICAN EAGLE OUTFITTERS	AEOS (1)	1373.4	19	-27	50.0	17.4	255	15	1.0	9.6	1.0	0.00	1.43	1.23	1.41	15.0	NR
NNTAYLOR STORES	ANN (1)	1064.8	24	2	21.1	9.2	153	17	0.8	10.3	0.9	0.00	0.67	1.69	1.93	15.0	8
SBURY AUTOMOTIVE GROUP	ABG	319.6	9	NA	NA	10.4	74	NA	0.1	NA	0.4	0.00	1.33	1.52	1.76	15.0	NR
UTONATION	AN	3882.1	12	0	122.9	8.0	97	12	0.2	9.3	0.9	0.00	0.73	1.19	1.25	12.0	B-
UTOZONE	AZO (8)	8110.2	82	14	28.6	62.1	1177	20	1.5	14.8	1.4	0.00	1.54	4.00*	4.81	15.0	8+
ARNES & NOBLE	8KS (1)	1527.9	24	-20	0.0	7.9	165	26	0.3	6.9	0.9	0.00	0.94	1.74	2.17	15.0	NR
ED BATH & BEYOND	8BBY (2)	10150.3	35	2	29.5	20.8	820	40	3.1	30.8	1.4	0.00	0.74	0.96	1.18	25.0	A-
EST BUY	BBY (2)	8901.3	28	-44	54.8	23.6	374	16	0.4	10.0	0.9	0.00	1.77	1.66	1.92	18.0	8
LOCKBUSTER	8BI	3901.6	22	-14	NM	3.7	95	26	0.7	8.9	1.1	0.37	-1.37	1.31	1.53	15.0	NR
ORDERS GROUP	BGP (1)	1458.6	18	-8	0.5	12.4	158	13	0.4	6.9	0.9	0.00	1.06	1.47	1.65	14.0	NR
URLINGTON COAT FACTORY	BCF (5)	919.6	21	23	14.0a	10.1	130	13	0.3	6.9	1.1	0.10	1.50	1.89	2.08	10.0	B+
ARMAX	KMX (2)	2030.3	20	-13	NM	17.6	366	22	0.6	17.9	0.9	0.00	0.82	0.96	1.16	22.0	NR
DW COMPUTER CENTERS	CDWC	4252.4	51	-5	35.2	21.1	493	25	1.0	21.5	1.1	0.00	1.89	2.09	2.27	22.0	8+
HARMING SHOPPES	CHRS (1)	581.1	5	-11	NM	2.3	93	53	0.2	6.4	0.9	0.00	-0.04	0.34	0.46	15.0	B-
RCUIT CITY STORES	CC (2)	2050.0	10	-62	8.1	7.7	79	10	0.2	6.0	1.7	0.72	0.92	0.38	0.53	15.0	8+
SK AUTO	CAO (1)	564.0	12	26	NM	8.1	196	22	0.4	10.6	1.1	0.00	-0.50	0.78	1.00	15.0	NR
OT LOCKER	Z (1)	1889.9	13	-14	-12.9	13.9	168	13	0.4	6.2	0.9	0.90	0.77	1.11	1.29	12.8	B-
OTSTAR	FTS	127.4	6	-80	NM	2.1	44	21	0.1	2.6	0.2	0.00	-1.16	1.92	2.00	14.3	NR
AP GPS	(1)	13830.7	16	14	NM	5.7	408	76	1.0	14.0	2.8	0.56	-0.01	0.38	0.58	15.0	A
ROUP 1 AUTOMOTIVE	GPI	539.8	24	-17	31.8a	16.0	122	8	0.1	6.4	1.9	2.18	3.96	2.89	3.27	20.0	NR
OLLYWOOD ENTERTAINMENT	HLW	1106.9	19	31	92.3	176.4	1104	6	0.8	2.5	0.9	0.00	1.90	1.23	1.45	17.0	C
OME DEPOT	HD (1)	61459.2	26	-48	25.1	18.3	305	17	1.1	13.5	1.1	0.91	1.29	1.57	1.78	16.0	A+
HUGHES SUPPLY	HUG (1)	754.2	32	2	-5.4	8.7	117	13	0.2	9.6	0.9	1.08	1.88	2.44	2.78	14.0	A-
-ANN STORES	JAS.A (1)	467.1	24	241	NM	14.8	179	12	0.3	6.2	0.6	0.00	-0.78	2.12	2.42	18.0	C
MITED BRANDS	LTO (1)	8893.8	17	16	32.7	10.5	196	16	1.0	10.7	1.2	1.76	1.19	1.05	1.20	14.0	8+
NENS 'N THINGS	LIN	1093.8	25	-2	2.2	5.9	174	29	0.5	13.5	0.9	0.00	0.72	1.57	1.80	17.0	8
THIA MOTORS	LAD	288.5	16	-22	17.7	10.0	93	9	0.1	7.3	NA	0.00	1.60	1.87	2.05	NA	NR
WE'S LOW	(1)	32404.8	42	-11	26.5	17.2	407	24	1.3	16.5	1.2	0.24	1.30	1.78	2.10	20.0	A+
EN'S WEARHOUSE	MW (1)	776.9	19	-8	2.8	7.6	152	20	0.6	9.4	1.3	0.00	1.04	1.04	1.34	14.3	8+
CHAEELS STORES	MIK (1)	2488.0	38	14	27.1	14.7	264	19	0.9	12.6	0.8	0.00	1.41	2.11	2.51	22.5	B-
FICE DEPOT	ODP	5464.6	18	-4	0.8	13.0	247	20	0.5	NA	1.2	0.00	0.66	1.01	1.13	14.5	B+
FICEMAX	OMX (1)	739.3	6	32	NM	-26.1	98	NM	0.2	NM	9.2	0.00	-2.72	0.06	0.22	11.0	NR
YLESS SHOESOURCE	PSS (1)	1284.4	57	1	-11.7	11.3	217	20	0.4	7.6	1.1	0.00	2.01	4.77	5.38	11.0	NR
CONNECTION	PCCC	171.6	7	-53	NA	1.2	117	100	0.2	NA	3.1	0.00	0.29	0.14	0.30	16.5	NR
P BOYS-MANNY, MOE & JACK	PBY (1)	553.8	11	-37	-3.6	7.7	86	12	0.3	4.4	1.0	2.51	0.69	0.96	1.11	11.5	B+
TCO ANIMAL SUPPLIES	PETC (1)	1449.7	25	NA	NM	NM	NM	NM	1.0	NA	1.1	0.00	-0.98	0.89	1.10	25.0	NR
TSMART	PETM (1)	2472.5	18	88	NM	14.8	388	27	0.9	16.7	1.1	0.00	0.34	0.72	0.90	22.5	C
ER 1 IMPORTS	PIR (2)	1801.8	20	13	8.3	19.8	301	16	1.1	11.1	1.0	1.03	1.04	1.33	1.53	14.0	B+
DIOSHACK	RSH	4031.1	24	-21	1.2	25.6	608	23	0.9	14.0	1.2	0.93	0.85	1.49	1.66	13.3	B+
GIS RGIS	(6)	1123.9	26	1	18.6	16.4	241	15	0.7	8.2	1.1	0.46	1.26	1.63*	1.85	15.0	B+
NT-A-CENTER	RCII	1749.6	50	48	17.3	14.5	216	14	0.9	3.2	0.7	0.00	1.79	4.79	5.38	15.0	NR
SS STORES	RST (1)	3597.0	46	44	12.8	32.5	607	19	1.1	14.7	1.2	0.41	1.91	2.50	2.87	15.0	A-
ERWIN-WILLIAMS	SHW	4330.0	29	5	2.9	22.4	324	15	0.8	10.5	1.3	2.08	1.68	2.04	2.23	10.5	A
NIC AUTOMOTIVE	SAH	740.2	18	-25	64.1	17.2	118	7	0.1	6.1	0.4	0.00	1.91	2.60	3.00	18.0	NR
ORTS AUTHORITY	TSA (1)	279.2	9	49	-14.2	13.7	171	13	0.2	4.5	0.9	0.00	0.37	0.71	0.76	14.0	NR
APLES SPLS	(1)	9078.3	19	3	NA	15.4	372	24	0.8	14.3	1.5	0.00	0.57	0.87	1.02	15.0	B+
LBOTS	TL8 (1)	1769.6	30	-16	119.0	22.8	323	15	1.1	9.7	1.0	1.19	2.00	2.03	2.34	15.0	B+
FANY	TIF (1)	4127.6	28	-10	23.0	16.3	367	23	2.5	17.0	1.3	0.56	1.15	1.23	1.43	18.0	A-
(TJX	(1)	10275.9	20	-2	20.8	42.5	754	18	0.9	13.1	1.2	0.61	0.97	1.10	1.30	15.0	B+
YS 'R' US TOY	(1)	2891.7	14	-34	-33.3	2.9	78	25	0.3	6.8	1.2	0.00	0.33	1.13	1.28	10.0	B-
ANS WORLD ENTERTAINMENT	TWMC (1)	165.5	4	-46	-13.1	1.8	38	27	0.1	3.1	2.0	0.00	0.39	0.12	0.15	17.5	B-
ITED AUTO GROUP	UAG	524.7	14	-48	NM	9.3	76	8	0.1	NA	0.5	0.00	1.31	1.85	2.08	15.5	NR
ITED RENTALS	URI	741.8	10	-57	94.0	8.8	49	7	0.3	1.4	0.6	0.00	1.30	1.13	0.98	15.0	NR
LLIAMS-SONOMA	WSM (1)	3053.9	26	23	13.4	19.1	512	27	1.3	16.0	1.3	0.00	0.65	1.04	1.25	20.0	B
LE ZLC	(7)	1198.4	36	-15	10.9	11.2	135	13	0.5	7.6	0.8	0.00	2.36	2.95*	3.05	15.0	NR

CONSUMER STAPLES

CTOR AVERAGE	12865.6	30	-7	14.9	28.4	431	21	1.1	11.5	1.7	1.61	1.13	1.76	1.99	11.2	
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FOOD & DRUG RETAILING

INDUSTRY GROUP AVERAGE	5302.9	19	-25	10.6	12.6	252	18	0.3	9.2	1.2	1.10	0.31	1.20	1.35	13.6		
BERTSON'S	ABS (1)	9429.4	23	-26	-10.2	17.1	170	10	0.3	NA	1.0	3.26	1.23	2.11	2.14	11.3	A

COMPANY	STOCK SYMBOL (FY)	MARKET VALUE	RECENT SHARE PRICE	2002 PRICE CHANGE %	EARNINGS GROWTH 1997-2001 %	RETURN ON EQUITY	PRICE AS % OF BOOK VALUE	P-E RATIO	PRICE-SALES RATIO	PRICE-CASH FLOW RATIO	P-E TO GROWTH RATE	YIELD %	ESTIMATES FROM ANALYSTS				S&P EQUI RANK
													2001 ACTUAL	2002 ANALYST EST.	CONSENSUS	LONG-TERM GROWTH RATE %	
CASEY'S GENERAL STORES CASY (4)		602.1	12	-19	0.0	8.2	153	18	0.3	7.7	1.5	0.82	0.64	0.83	0.97	10.0	A
CVS CVL		10559.2	27	-9	50.3	7.4	220	29	0.4	15.1	1.3	0.86	1.00	1.71	1.91	12.5	B
FLEMING FIN		408.8	8	-59	NM	6.0	61	9	0.0	2.5	0.4	1.07	0.60	1.02	1.72	20.0	B-
GREAT ATLANTIC & PACIFIC TEA GAP (2)		293.5	8	-68	NM	-37.7	55	NM	0.0	5.3	NM	0.00	-1.69	-0.79	-0.87	10.0	C
KROGER KR (1)		12016.1	16	-25	28.0a	33.4	319	10	0.2	5.1	0.9	0.00	1.26	1.66	1.76	10.9	B+
LDNGS DRUG STORES LDG (1)		776.6	20	-13	-4.3	6.5	109	16	0.2	6.2	1.6	2.77	1.25	1.19	1.33	10.5	A-
NASH FINCH NAFCE		100.6	8	-73	NM	12.2	46	4	0.0	1.4	0.2	4.26	1.78	2.32	2.48	16.3	B
PATHMARK STORES PTMK (1)		117.0	4	-84	NA	-14.0	33	NM	0.0	1.2	0.8	0.00	-7.96	0.40	0.40	12.0	NF
PERFORMANCE FOOD GROUP PFGE		1589.4	35	0	18.6	9.0	229	26	0.4	16.3	1.2	0.00	1.03	1.49	1.78	19.0	B-
RITE AID RAD (2)		1205.4	2	-54	NM	NM	NM	NM	0.1	NA	NM	0.00	-1.68	-0.25	-0.02	12.5	C
RUDDICK RDK (9)		670.6	14	-10	2.9	11.4	147	13	0.3	5.5	1.2	2.49	-0.02	1.12*	1.33	11.0	A-
SAFEWAY SWY		10648.7	24	-43	16.5	26.4	220	9	0.3	4.9	0.7	0.00	2.44	2.76	2.51	11.7	B-
7-ELEVEN SE		841.9	8	-32	1.2	46.4	488	11	0.1	2.4	1.0	0.00	0.83	0.67	0.69	12.5	B
SUPERVALU SVU (2)		2402.5	18	-19	-5.1	11.4	120	11	0.1	4.4	0.9	3.17	1.48	2.11	2.34	9.0	B-
SYSCO SY (6)		19227.1	29	12	21.0	31.8	876	28	0.8	19.7	1.9	1.50	0.88	1.01*	1.18	15.0	A-
UNITED NATURAL FOODS UNFI (7)		492.1	26	3	5.0	11.3	299	27	0.4	18.0	1.4	0.00	0.71	0.89*	1.19	20.0	B
WALGREEN WAG (8)		29507.1	29	-14	16.7	16.4	474	29	1.0	22.2	1.7	0.52	0.86	0.99*	1.13	17.0	A-
WHOLE FOODS MARKET WFMI (9)		3068.8	53	22	18.5	14.3	521	38	1.1	18.0	1.9	0.00	0.92	1.40*	1.66	20.0	B
WINN-DIXIE STORES WIN (6)		2100.2	15	5	0.4	22.9	249	11	0.2	NA	1.1	1.34	0.55	1.35*	1.43	10.0	B+

7 FOOD BEVERAGE & TOBACCO

INDUSTRY GROUP AVERAGE		14179.9	32	1	19.1	25.5	444	22	1.2	11.4	1.8	1.94	1.54	2.09	2.32	10.2	
(A) BEVERAGES																	
INDUSTRY AVERAGE		28688.2	40	8	20.1	22.9	497	21	2.0	11.8	1.6	1.05	1.64	2.19	2.43	12.0	
ANHEUSER-BUSCH BUD		42042.1	49	9	12.6	50.1	1112	23	3.1	15.3	1.9	1.59	1.89	2.20	2.47	12.0	A-
BROWN-FORMAN BF.B (4)		4521.3	66	6	5.7	17.3	347	20	2.2	16.1	2.2	2.27	3.33	3.63	3.92	8.2	A-
CDCA-CDLA KO		113183.3	46	-3	-1.1	35.9	975	27	5.7	22.7	2.3	1.75	1.60	1.76	1.93	11.5	A-
COCA-COLA ENTERPRISES CCE		9548.8	21	12	NM	11.4	292	26	0.6	6.4	1.6	0.75	-0.05	1.01	1.16	13.5	B
CONSTELLATION BRANDS STZ (2)		2121.3	24	10	26.5	15.3	197	13	0.8	9.7	0.8	0.00	1.57	2.02	2.30	14.5	B
CORDS (ADDLPH) RKY		2349.6	65	21	10.8	13.7	204	15	0.7	6.5	1.4	1.26	3.31	4.68	5.06	10.0	B
PEPSI BOTTLING GROUP PBG		8099.0	29	22	18.6	19.6	414	22	0.9	10.2	1.3	0.14	1.03	1.44	1.71	15.0	N
PEPSIAMERICAS PAS		2286.0	15	10	38.0	9.2	153	17	0.7	7.4	1.4	0.26	0.58	1.01	1.13	11.0	B
PEPSICO PEP		74042.6	42	-13	49.8	33.3	778	24	2.9	NA	1.8	1.41	1.47	1.96	2.19	12.0	A
(B) FOOD PRODUCTS																	
INDUSTRY AVERAGE		7945.8	29	2	15.6	24.6	444	24	1.0	12.0	1.9	1.53	1.16	1.69	1.95	9.8	
ARCHER DANIELS MIDLAND ADM (6)		8621.1	13	-7	7.2	7.2	128	18	0.3	8.1	1.9	1.80	0.58	0.78*	0.74	9.0	B
BUNGE BG		2436.9	25	5	3.3	18.8	200	10	0.2	6.1	1.2	1.57	1.72	2.36	2.59	9.0	N
CAMPBELL SOUP CPB (7)		9901.5	24	-19	-4.2	NM	NM	18	1.6	11.7	2.7	2.61	1.55	1.28*	1.47	7.0	B
CDNAGRA FOODS CAG (5)		13081.4	24	3	2.1	18.3	292	16	0.5	9.3	1.9	4.06	1.47	1.62	1.76	8.0	A
CORN PRODUCTS INTERNATIONAL CPO		1058.2	30	-16	NM	7.0	132	19	0.6	6.4	1.9	1.35	1.60	1.60	1.94	10.0	N
DEAN FOODS DF		3383.8	37	9	32.8	13.0	195	16	0.4	8.4	1.5	0.00	1.86	2.78	3.05	9.0	N
DEL MONTE FOODS DLM (6)		465.6	9	5	195.3	153.7	1573	10	0.3	6.1	1.2	0.00	0.76	0.75*	0.94	10.0	N
DDLE FOOD DOL		1658.5	30	10	NM	19.0	223	12	0.4	NA	0.9	2.03	-0.66	2.68	3.02	12.0	B
DREYER'S GRAND ICE CREAM DRYR		2446.0	70	82	9.6	10.1	1050	113	1.8	41.7	4.9	0.34	0.24	0.95	1.25	15.0	E
FLDWEBS FOODS FLO		717.2	24	-10	NM	1.8	112	65	0.4	8.2	3.6	0.21	-0.61	0.83	1.21	8.0	N
FRESH DEL MONTE PRODUCE FDP		1282.7	23	52	17.5	23.5	176	7	0.6	6.2	0.7	0.87	1.77	3.19	3.41	10.0	N
GENERAL MILLS GIS (5)		16420.2	45	-14	1.1	12.2	449	36	1.8	21.1	1.7	2.47	1.35	2.58	3.02	10.0	E
HEINZ (H.J.) HNZ (4)		12224.6	35	-15	2.1	43.4	711	15	1.3	NA	1.8	4.65	2.36	2.47	2.48	8.0	E
HERSHEY FOODS HSY		8780.9	64	-5	-9.3	16.7	641	39	1.9	21.2	2.0	2.03	1.50	3.16	3.45	10.0	A
HORMEL FOODS HRL (10)		3099.2	22	-17	10.0	17.0	278	17	0.8	11.1	1.5	1.88	1.30	1.35*	1.56	11.0	A
INTERNATIONAL MULTIFOODS IMC (2)		381.3	20	-16	-21.5	6.6	180	28	0.2	9.4	1.2	0.00	0.50	1.59	1.75	10.5	E
INTERSTATE BAKERIES IBC (5)		1016.7	23	-5	-5.5	26.6	311	13	0.3	5.6	1.4	1.21	1.36	1.99	2.22	8.5	E
KELLOGG K		13608.3	33	11	-3.3	59.8	1244	21	1.6	13.2	2.1	3.03	1.18	1.73	1.89	9.0	E
KRAFT FOODS KFT		65084.8	38	10	-1.2	11.9	257	22	2.1	16.5	1.5	1.60	1.17	2.03	2.25	12.0	N
MCCORMICK MKC (11)		3328.9	24	13	13.4	27.6	569	21	1.4	14.6	1.7	1.85	1.05	1.30	1.44	11.0	A
PILGRIM'S PRIDE CHX (9)		343.7	8	-38	-26.7	3.6	87	24	0.1	4.1	2.7	0.72	1.02	0.35*	0.57	9.0	E
RALCDRP RAH (9)		705.6	24	4	7.7	12.3	161	13	0.6	7.7	1.3	0.00	1.33	1.77*	2.12	10.0	E
SARA LEE SLE (6)		18190.6	23	5	NM	59.6	1023	18	1.0	11.7	2.4	2.66	1.87	1.23*	1.59	7.9	A
SMITHFIELD FOODS SFD (4)		2074.2	19	-14	26.5	7.0	153	22	0.3	8.3	2.5	0.00	1.78	0.76	1.77	10.0	E
TYSON FOODS TSN (9)		4165.4	12	2	77.8	10.5	114	11	0.2	5.1	1.2	1.36	0.40	1.08*	1.10	9.0	E
WRIGLEY (WM.) JR. WWY		12114.0	54	5	8.3	26.6	841	31	4.6	25.8	2.7	1.52	1.61	1.78	1.98	11.0	A
(C) TOBACCO																	
INDUSTRY AVERAGE		22057.9	36	-15	36.1	37.0	324	8	1.3	5.2	1.0	6.61	3.85	4.41	4.52	8.7	
PHILIP MORRIS MO		78446.4	38	-18	10.8	53.9	368	7	1.2	6.0	0.8	6.79	3.88	4.57	4.78	10.0	A
R.J. REYNOLDS TOBACCO HOLDINGS RJR		3429.1	39	-31	127.7	8.1	46	6	0.5	4.1	0.9	9.84	4.48	6.14	6.05	7.0	I
UNIVERSAL UVV (6)		916.9	35	-3	0.0	17.6	151	9	0.4	5.6	0.9	3.84	4.08	4.00*	4.13	10.3	A
UST UST		5439.3	32	-8	5.8	68.5	733	11	3.3	NA	1.5	5.96	2.97	2.95	3.13	7.5	A

EARNINGS PER SHARE

ESTIMATES FROM ANALYSTS

LONG-TERM

GROWTH

RATE

S&P

EQUITY

RANKING

COMPANY STOCK SYMBOL (FY)	MARKET VALUE	RECENT SHARE PRICE	2002 PRICE CHANGE %	EARNINGS GROWTH 1997-2001 %	RETURN ON EQUITY	PRICE AS % OF BOOK VALUE	P-E RATIO	PRICE- SALES RATIO	PRICE- CASH FLOW RATIO	P-E TO GROWTH RATE	YIELD %	2001 ACTUAL	2002 ANALYST EST.	CON- SENSUS	LONG-TERM GROWTH RATE %	S&P EQUITY RANKING
HOUSEHOLD & PERSONAL PRODUCTS																
INDUSTRY GROUP AVERAGE	22865.5	41	-3	5.3	80.0	850	25	1.9	17.2	2.3	1.37	1.20	1.59	1.97	10.7	
A) HOUSEHOLD PRODUCTS																
INDUSTRY AVERAGE	35006.1	50	2	7.7	115.3	973	22	2.2	15.6	2.2	1.70	1.82	2.26	2.74	10.4	
LOROX CLX (6)	9645.8	44	11	-1.7	30.8	741	25	2.3	16.5	3.2	2.01	1.36	1.37*	2.25	10.0	A
COLGATE-PALMOLIVE CL	27661.3	51	-11	13.4	377.3	NM	24	3.0	17.9	2.0	1.40	1.89	2.19	2.43	12.0	A
IAL DL	1978.5	21	21	NA	110.9	1934	17	1.4	NA	1.6	0.77	0.76	1.22	1.34	11.0	NR
IMBERLY-CLARK KMB	25914.8	50	-16	14.5	25.3	431	16	1.9	10.9	1.6	2.38	3.02	3.44	3.67	9.0	B+
ROCTER & GAMBLE PG (6)	109829.8	85	7	4.4	32.2	787	25	2.7	17.1	2.7	1.94	2.07	3.09*	3.99	10.0	A
B) PERSONAL PRODUCTS																
INDUSTRY AVERAGE	10724.9	32	-9	2.9	21.3	685	30	1.6	18.9	2.3	1.03	0.57	0.92	1.20	11.0	
LBERTO-CULVER ACV (9)	2878.7	50	11	13.2	16.0	334	21	1.1	16.4	1.9	0.73	1.91	2.32*	2.62	11.0	A+
VON PRODUCTS AVP	12099.2	51	10	9.2	NM	NM	27	2.0	21.1	1.9	1.56	1.79	2.31	2.57	12.0	A
STEE LAUER EL (6)	6363.1	27	-15	-3.2	9.5	459	40	1.3	17.9	2.9	0.73	1.17	0.78*	1.25	12.0	NR
ILLETTE G	32078.6	30	-9	-7.6	38.4	1261	30	3.5	20.2	2.7	2.14	0.86	1.14	1.27	10.0	A-
EVLOX REV	205.0	4	-41	NM	NM	NM	NM	0.2	NM	NM	0.00	-2.87	-1.95	-1.68	10.0	NR
ENERGY																
SECTOR AVERAGE	14247.0	35	-4	25.4	3.0	207	72	1.5	11.7	2.6	1.39	2.99	1.45	2.29	12.4	
ENERGY																
INDUSTRY GROUP AVERAGE	14247.0	35	-4	25.4	3.0	207	72	1.5	11.7	2.6	1.39	2.99	1.45	2.29	12.4	
A) ENERGY EQUIPMENT & SERVICES																
INDUSTRY AVERAGE	6278.0	30	8	-1.3	7.8	254	61	1.8	14.8	1.9	0.42	1.31	0.96	1.33	17.4	
AKER HUGHES BHI	11003.9	33	-10	19.6	10.5	319	31	2.1	NA	2.3	1.41	1.30	0.94	1.31	15.0	B
I SERVICES BJS (9)	5243.3	33	3	7.6	11.8	371	32	2.8	19.3	2.1	0.00	2.09	1.04*	1.27	15.0	B
DOOPER CAMERON CAM	2785.6	51	27	-9.4	9.1	273	31	1.8	16.0	2.0	0.00	1.75	1.51	2.05	17.0	NR
MC TECHNOLOGIES FTI	1260.3	19	17	NA	21.7	449	21	0.6	11.3	1.0	0.00	0.60	0.93	1.10	20.0	NR
ALLIBURTON HAL	9317.3	21	63	-4.2	-1.7	216	NM	0.8	19.8	1.6	2.34	1.28	0.89	1.25	15.0	B
ABORS INDUSTRIES NBR	5112.4	35	3	19.0	6.9	239	36	3.4	15.4	4.0	0.00	2.18	0.71	1.29	12.4	B
ATIONAL-OILWELL NOI	1761.7	22	6	6.3	9.1	191	21	1.1	15.6	1.2	0.00	1.27	0.92	1.11	20.0	NR
RIDE INTERNATIONAL PDE	1862.7	14	-7	-20.7	-0.4	110	NM	1.5	8.8	NM	0.00	0.67	-0.07	0.63	20.0	B-
CHLUMBERGER SLB	25694.2	44	-19	-18.1	8.3	295	35	1.9	NA	2.0	1.69	0.91	1.34	1.73	17.0	B
WITH INTERNATIONAL SH	3370.3	34	27	4.7	10.9	323	30	1.0	16.5	2.2	0.00	1.52	1.02	1.42	15.0	B
ANSOCEAN RIG	7757.0	24	-28	-22.0	4.7	78	17	2.8	7.7	1.5	0.00	0.86	1.08	1.27	15.0	B+
IRCO INTERNATIONAL VRC	1585.0	16	9	-6.9	9.6	177	19	1.2	10.8	0.8	0.00	0.86	0.86	1.09	25.0	B
EATHERFORD INTERNATIONAL WFT	4860.2	40	8	8.6	0.9	257	403	2.1	21.1	1.6	0.00	1.76	1.29	1.72	20.0	B-
B) OIL & GAS																
INDUSTRY AVERAGE	18751.2	38	-11	43.2	0.3	180	79	1.3	10.1	3.1	1.93	3.94	1.73	2.84	9.5	
ERADA HESS AHC	4995.3	56	-10	237.5	4.4	107	24	0.4	3.3	1.0	2.14	10.25	6.03	4.86	9.2	B-
ADARKO PETROLEUM APC	11767.0	47	-17	NM	9.2	176	20	2.9	6.7	0.9	0.85	-0.73	2.94	3.38	17.5	B
ACHE APA	7756.9	54	8	34.9	9.2	166	17	3.3	5.9	2.5	0.74	4.97	3.78	3.96	5.8	B+
HLANO ASH (9)	1983.6	29	-37	NA	5.9	91	16	0.3	5.7	2.1	3.77	5.73	1.83*	4.13	7.6	B
IRLINGTON RESOURCES BR	8480.1	42	12	12.4	5.9	229	39	3.1	6.9	2.1	1.31	2.69	1.70	1.88	12.0	B-
EVROTEXACO CVX	71598.6	67	-25	-9.5	-6.7	223	NM	0.8	13.3	2.0	4.18	3.70	4.52	4.89	7.4	B+
INOCOPHILLIPS COP	32354.5	48	-21	11.4	1.2	108	48	0.8	14.5	1.9	3.35	5.57	3.11	4.28	8.0	B+
VON ENERGY DVN	7165.7	46	18	NM	-12.4	158	NM	1.9	10.6	1.5	0.44	0.34	3.02	3.87	10.0	B
G RESOURCES EOG	4478.7	39	-1	44.0	0.4	295	775	4.5	9.5	6.5	0.41	3.30	0.80	1.41	7.5	B+
XON MOBIL XOM	234169.2	35	-11	7.3	13.5	314	24	1.4	12.7	2.9	2.64	2.18	1.62	1.90	7.5	A-
ONTIER OIL FTO	375.0	14	-14	95.9	-7.4	225	NM	0.2	26.1	NM	1.39	4.00	-0.62	1.89	12.8	B-
RR-McGEE KMG	4542.1	45	-17	6.6	-10.9	156	NM	1.3	6.8	2.0	3.98	4.93	2.49	2.78	9.0	B
RATHON OIL MRO	6197.4	20	-33	29.2	7.7	124	16	0.2	3.9	1.3	4.60	4.26	1.76	2.10	8.6	B
URPHY OIL MUR	3928.6	86	2	25.5	5.3	253	48	1.0	10.1	3.5	1.87	7.26	2.05	4.29	12.0	B+
BLE ENERGY NBL	2120.3	37	5	7.8	-2.7	212	NM	1.7	7.9	15.0	0.43	2.33	0.25	0.72	10.0	B-
CIOENTAL PETROLEUM OXY	10498.1	28	5	69.0	9.9	174	18	1.4	NA	1.1	3.59	3.17	2.62	2.40	9.3	B
EAN ENERGY OEI	3320.1	19	-2	24.5	6.3	219	35	3.2	7.3	1.7	0.85	1.55	1.03	1.25	11.0	NR
EMCOR PCO	1186.8	21	NA	NM	-31.1	180	NM	0.2	NM	NM	0.00	4.49	-0.51	2.42	3.0	NR
NOCO SUN	2259.3	30	-21	12.9	-6.7	150	NM	0.2	9.9	NM	3.38	4.85	-0.53	3.62	8.0	B+
SORO PETROLEUM TSO	277.8	4	-67	123.9	-9.3	30	NM	0.0	27.8	NM	0.00	2.10	-1.52	1.21	11.8	B-
OCAL UCL	7254.2	30	-18	-0.2	6.4	228	36	1.5	6.1	1.7	2.70	2.43	1.72	1.69	10.0	B
LERO ENERGY VLO	3399.9	32	-16	44.0	1.3	81	39	0.2	8.0	5.4	1.25	8.83	0.59	4.80	10.0	NR
ESTERN GAS RESOURCES WGR	1167.9	35	9	NM	7.4	240	33	0.5	10.0	2.9	0.57	2.48	1.20	1.58	10.2	B
FINANCIALS																
CTOR AVERAGE	15278.6	597	-7	5.5	11.0	191	21	1.8	15.3	1.8	2.14	5.62	23.38	27.13	11.7	
BANKS																
INDUSTRY GROUP AVERAGE	13800.2	36	0	6.8	15.3	220	15	2.5	11.3	1.3	2.86	2.13	2.73	3.00	10.6	
SOUTH BANCORPORATION ASO	6823.0	19	1	5.0	19.0	218	12	2.2	9.8	1.3	4.82	1.45	1.68	1.78	9.0	A-
SOCIATED BANC-CORP ASBC	2501.2	34	5	38.0	16.0	197	12	2.5	9.9	1.4	3.70	2.46	2.77	2.99	8.8	A

COMPANY STOCK SYMBOL (FY)	MARKET VALUE	RECENT SHARE PRICE	PRICE CHANGE %	EARNINGS GROWTH 1999-2001 %	RETURN ON EQUITY	PRICE AS % OF BOOK VALUE	P-E RATIO	PRICE-SALES RATIO	PRICE-CASH FLOW RATIO	P-E TO GROWTH RATE	YIELD %	ESTIMATES FROM ANALYSTS				
												2001 ACTUAL	2002 ANALYST EST	CON-SENSUS	LONG-TERM GROWTH RATE %	S&P EQU RANK
ASTORIA FINANCIAL AF	2304.5	26	-1	17.8	14.9	146	10	1.6	8.9	0.8	3.04	2.38	2.85	3.07	11.5	N
BANK OF AMERICA BAC	105271.5	70	11	3.5	18.0	21.9	13	2.2	10.6	1.2	3.65	4.18	5.68	6.19	10.0	A
BANK OF NEW YORK BK	22010.7	30	-26	6.3	17.1	332	19	3.6	16.2	1.5	2.50	1.81	1.58	2.01	13.0	A
BANK ONE ONE	46343.0	39	1	-2.1	13.7	211	16	2.0	13.4	1.4	2.13	2.28	2.77	3.09	10.0	A
BANKNORTH GROUP BNK	3259.1	22	-2	14.7	14.9	169	11	2.2	9.8	1.1	2.72	1.71	2.05	2.24	10.0	B
BB&T BBT	18251.9	38	5	13.6	16.4	242	15	2.4	12.5	1.3	3.05	2.12	2.75	3.00	11.0	A
BOK FINANCIAL BOKF	1741.7	33	7	13.4	14.3	178	14	2.0	8.3	1.1	0.00	1.95	2.42	2.56	12.0	B
CHARTER ONE FINANCIAL CF	6815.2	30	16	19.9	18.8	226	13	2.4	NA	1.0	2.92	2.11	2.44	2.69	12.0	A
CITY NATIONAL CYN	2275.9	45	-3	15.1	15.8	202	13	3.0	11.3	1.2	1.72	2.96	3.50	3.83	11.0	B
COLONIAL BANC GROUP CNB	1503.6	12	-14	9.7	13.2	143	10	1.7	NA	1.1	4.28	1.06	1.19	1.26	9.5	A
COMERICA CMA	8268.1	47	-17	5.5	12.2	170	14	2.2	12.5	1.4	4.06	3.88	3.40	4.76	10.0	A
COMMERCE BANCORP CBH	3078.4	46	16	18.0	15.2	353	24	3.2	NA	1.5	1.31	1.51	2.02	2.37	15.0	A
COMMERCE BANCSHARES CBSH	2696.7	40	8	10.2	14.0	193	14	2.9	11.7	1.5	1.63	2.60	2.88	3.14	9.0	A
COMPASS BANCSHARES CBSS	4161.5	32	14	10.9	15.4	210	14	2.3	9.7	1.3	3.10	2.11	2.41	2.64	10.0	A
FIFTH THIRD BANCORP FITB	32397.4	56	-9	8.3	19.1	387	21	5.2	NA	1.4	1.86	1.87	2.76	3.13	14.0	A
FIRST TENNESSEE NATIONAL FTN	4634.5	37	2	13.8	22.3	285	13	1.9	7.0	1.3	3.25	2.51	2.86	3.07	10.0	A
FIRST VIRGINIA BANKS FVB	2702.8	38	11	9.0	14.2	218	15	3.5	NA	2.0	2.97	2.32	2.55	2.70	7.5	A
FIRSTMERIT FMER	1917.6	23	-16	0.7	12.3	198	16	2.3	13.9	1.2	4.41	1.42	1.86	2.04	10.0	B
FLEETBOSTON FINANCIAL FBFI	28424.1	27	-26	-22.4	4.2	171	40	1.9	22.0	1.8	5.16	0.83	1.47	2.51	10.0	B
GOLDEN WEST FINANCIAL GDW	10643.9	69	18	25.8	19.5	222	12	2.8	10.9	1.0	0.49	5.11	6.00	6.38	12.0	A
GREENPOINT FINANCIAL GPT	4200.1	43	19	20.3	25.4	220	8	2.4	6.3	0.8	2.34	4.50	5.51	5.67	10.0	N
HIBERNIA HIB	3088.1	20	10	11.1	14.6	187	13	2.3	11.3	1.4	3.07	1.35	1.60	1.79	9.0	E
HUNTINGTON BANCSHARES HBAN	4648.7	20	14	-11.4	14.7	199	14	2.2	11.3	1.8	3.27	0.71	1.33	1.47	8.0	E
KEYCORP KEY	11084.7	26	7	-35.1	8.4	167	20	1.8	NA	1.4	4.60	0.37	2.27	2.39	8.0	A
M&T BANK MTB	7411.7	81	11	10.4	15.1	242	17	3.1	12.2	1.6	1.49	3.82	5.07	5.54	10.0	A
MARSHALL & ILSLEY M	5968.7	28	-10	5.1	16.9	219	14	2.3	NA	1.3	2.25	1.55	2.18	2.32	10.0	A
MELLON FINANCIAL MEL	12949.8	30	-20	-1.8	13.8	389	29	2.4	19.9	1.6	1.73	0.91	1.56	1.91	12.0	A
MERCANTILE BANKSHARES MRBK	2727.4	39	-9	8.6	14.0	205	15	3.7	13.5	1.6	3.06	2.55	2.72	2.94	8.8	A
NATIONAL CITY NCC	17018.6	28	-5	7.2	19.1	209	11	2.0	8.1	1.3	4.39	2.27	2.58	2.61	8.0	A
NATIONAL COMMERCE FINANCIAL NCF	5129.8	25	-1	11.6	11.3	194	17	3.4	NA	1.2	2.73	1.09	1.57	1.76	13.0	A
NORTH FORK BANCORPORATION NFB	5691.4	35	9	13.6	24.2	344	14	4.4	13.2	1.2	2.87	2.05	2.58	2.82	11.6	E
NORTHERN TRUST NTRS	8549.7	39	-36	12.3	15.3	303	19	3.0	13.9	1.5	1.76	2.11	2.03	2.18	13.0	A
PNC FINANCIAL SERVICES GROUP PNC	12001.7	42	-25	-21.2	7.3	179	25	1.9	NA	1.2	4.55	1.26	4.18	4.01	8.5	E
POPULAR BPOP	4450.4	34	16	9.7	14.8	192	13	1.8	10.2	0.9	2.38	2.17	2.63	2.91	14.0	A
PROVIDENT FINANCIAL GROUP PFGI	1361.6	28	7	-34.6	6.0	142	24	1.1	13.2	1.4	3.43	0.46	2.35	2.62	8.5	E
REGIONS FINANCIAL RF	7694.1	35	16	4.6	14.7	188	13	2.0	11.4	1.6	3.34	2.24	2.72	2.88	8.0	A
SOUTHTRUST SOTR	9066.5	26	6	12.3	13.8	200	15	2.7	12.8	1.3	2.60	1.61	1.85	2.00	11.0	A
SOVEREIGN BANCORP SOV	3614.3	14	13	-7.6	11.9	133	12	1.5	7.5	0.9	0.72	0.48	1.29	1.41	12.0	A
SUNTRUST BANKS STI	16720.6	59	-6	11.5	15.0	189	13	2.2	NA	1.4	2.93	4.70	4.78	4.96	9.0	A
SYNOVUS FINANCIAL SNV	6242.8	21	-17	14.2	17.7	319	18	2.8	NA	1.2	2.83	1.05	1.20	1.36	15.0	A
TCF FINANCIAL TCB	3171.5	43	-11	12.2	23.9	334	14	2.8	11.0	1.0	2.70	2.70	3.15	3.49	13.0	A
U.S. BANCORP USB	41932.2	22	5	0.9	18.1	239	13	2.7	NA	1.2	3.56	0.88	1.84	2.00	10.0	A
UNION PLANTERS UPC	5901.7	30	-2	6.2	15.5	183	12	2.2	8.9	1.3	4.52	2.13	2.55	2.73	9.0	A
UNIONBANCAL UB	6545.1	44	15	7.2	14.2	180	13	2.5	NA	1.5	2.57	3.04	3.31	3.82	9.0	A
WACHOVIA WB	48261.0	35	12	-15.2	10.6	150	14	2.0	9.3	1.3	2.96	1.46	2.78	3.03	10.0	A
WASHINGTON MUTUAL WM	34316.0	36	10	32.4	17.1	170	10	1.9	5.7	0.7	3.11	3.15	4.02	4.33	12.0	A
WELLS FARGO WFC	78486.8	46	6	6.1	18.0	261	15	2.8	9.6	1.2	2.42	1.97	3.32	3.64	12.0	A
ZIONS BANCORPORATION ZION	3751.0	41	-22	13.0	12.9	159	12	2.0	9.1	0.9	1.94	3.15	3.64	3.97	12.5	A

11 DIVERSIFIED FINANCIALS

INDUSTRY GROUP AVERAGE	24391.8	37	-17	7.9	10.9	228	24	1.6	13.1	3.5	1.16	2.28	2.67	2.89	13.7	
AMERICAN EXPRESS AXP	51582.3	39	9	-8.8	16.3	369	23	2.1	NA	1.6	0.82	0.98	2.00	2.25	12.0	
AMERICREDIT ACF (6)	714.3	8	-74	49.5	22.6	48	2	0.6	1.9	0.1	0.00	2.60	3.87*	0.65	15.0	
BEAR STEARNS BSC (11)	6249.8	64	9	4.8	13.5	119	10	0.9	6.1	1.0	1.06	4.31	5.30	5.35	12.0	
CAPITAL ONE FINANCIAL COF	7495.8	34	-37	33.6	19.3	173	9	0.8	7.0	0.4	0.32	2.91	3.93	4.50	20.0	
CITIGROUP C	19681.3	39	-23	17.5	18.0	248	14	2.1	NA	0.9	1.85	2.75	2.90	3.34	14.5	
COUNTRYWIDE FINANCIAL CFC	6219.2	49	20	NA	NA	127	8	0.8	3.4	0.6	0.97	NA	6.41	6.87	13.0	
E*TRADE GROUP ET	2062.0	6	-45	NM	5.6	141	26	1.1	NA	0.8	0.00	-0.81	0.45	0.61	15.0	
EDWARDS (A.G.) AGE (2)	2854.3	36	-18	-25.0	3.1	175	57	1.2	NA	1.4	1.77	0.88	1.72	2.16	15.0	
FANNIE MAE FNM	62608.6	63	-21	19.8	37.3	471	11	1.2	10.3	0.7	2.09	5.89	6.29	7.06	14.0	
FRANKLIN RESOURCES BEN (9)	9553.6	37	5	-4.3	10.1	224	22	3.8	16.5	1.5	0.76	1.91	1.65*	1.85	14.5	
FREDDIE MAC FRE	39976.8	58	-12	33.2	23.0	225	8	1.0	7.4	0.8	1.53	5.96	5.11	5.75	14.2	
GOLDMAN SACHS GROUP GS (11)	37764.6	79	-15	NA	11.2	200	20	1.6	13.1	1.5	0.61	4.26	4.04	4.63	13.0	
HOUSEHOLD INTERNATIONAL HI	13053.6	29	-50	20.2	17.7	155	8	0.9	NA	0.5	3.48	3.91	4.45	4.22	14.0	
INSTINET GROUP INET	1152.3	4	-65	-1.9	-47.7	103	NM	1.0	NM	63.6	0.00	0.63	0.01	0.16	11.0	
J.P. MORGAN CHASE JPM	50235.9	25	-31	-24.3	3.8	118	31	1.2	11.2	1.4	5.40	0.81	1.68	2.44	11.0	
LEGG MASON LM (3)	3472.1	52	3	16.9	15.5	297	20	2.1	14.6	1.5	0.85	2.24	2.75	3.09	12.5	
LEHMAN BROTHERS HOLDINGS LEH (11)	14676.7	61	-8	18.5	9.5	179	19	0.9	12.9	1.4	0.59	4.38	3.68	4.40	12.0	
MBNA KRB	27265.5	21	-9	25.3	20.3	319	16	2.6	NA	0.9	1.31	1.28	1.52	1.75	15.0	
MERRILL LYNCH MER	37784.6	44	-17	-30.2	3.0	173	79	1.3	25.7	1.3	1.47	0.57	2.60	3.00	13.0	

INVESTMENT OUTLOOK SCOREBOARD

COMPANY STOCK SYMBOL (FY)	MARKET VALUE	RECENT SHARE PRICE	2002 PRICE CHANGE %	EARNINGS GROWTH 1997-2001 %	RETURN ON EQUITY	PRICE AS % OF BOOK VALUE	P-E RATIO	PRICE-SALES RATIO	PRICE-CASH FLOW RATIO	P-E TO GROWTH RATE	YIELD %	EARNINGS PER SHARE				
												ESTIMATES FROM ANALYSTS				
												2001 ACTUAL	2002 ANALYST EST.	CONSENSUS	LONG-TERM GROWTH RATE %	S&P EQUITY RANKING
ETRIS MXT	251.5	4	-83	41.8	4.3	36	9	0.2	NA	NM	0.92	2.62	-0.44	0.12	12.5	NR
ORGAN STANLEY MWD (11)	49449.7	45	-19	10.7	14.6	231	16	1.5	NA	1.2	2.03	3.19	2.80	3.18	13.0	A-
PRINCIPAL FINANCIAL GROUP PFG	9952.8	29	21	NA	6.4	150	NA	1.2	NA	1.1	0.86	NA	2.16	2.34	12.0	NR
PROVIDENT FINANCIAL PVN	1758.1	6	71	NA	-12.0	83	NM	0.4	NM	1.2	0.00	0.49	0.33	0.68	15.0	NR
RAYMOND JAMES FINANCIAL RJF (9)	1565.1	32	-10	-4.0	9.4	185	20	1.0	NA	NA	1.13	1.98	1.60*	1.73	NA	B+
SCHWAB (CHARLES) SCH	15584.3	12	-25	-30.0	3.9	376	96	3.4	30.6	2.3	0.38	0.06	0.31	0.42	16.5	A
SLM	15005.4	98	16	-4.4	40.6	904	21	4.5	20.0	1.5	1.02	2.28	4.59	5.33	14.0	A-
STATE STREET STT	14595.3	45	-14	-4.9	16.3	336	21	2.9	NA	1.4	1.07	1.90	2.19	2.36	14.3	A+
TELEWELL FINANCIAL SV	3274.1	15	-46	26.8	8.0	230	33	2.7	15.9	1.2	0.27	1.31	0.98	0.79	12.3	NR
INSURANCE																
INDUSTRY GROUP AVERAGE	12131.7	1577	-10	3.0	6.9	141	24	1.1	22.6	1.3	1.51	11.70	59.55	69.43	11.7	
ACE	8951.1	34	-15	NM	3.9	139	35	1.3	28.7	0.8	1.94	-0.64	3.13	4.05	13.8	B+
AFL	15892.9	31	26	5.2	13.1	260	21	1.6	NA	1.3	0.78	1.28	1.54	1.77	15.0	A+
AMERICA FINANCIAL AFC	582.5	11	-75	NM	-18.4	28	NM	0.2	NM	NM	0.00	0.00	-5.48	1.47	10.0	NR
ALLSTATE ALL	27438.1	39	16	-18.0	7.2	154	22	0.9	NA	1.4	2.15	1.61	2.87	3.30	10.0	B-
AMERICAN FINANCIAL GROUP AFG	1638.1	24	-3	NM	6.5	95	15	0.4	5.5	0.8	2.11	-0.07	2.39	2.74	13.0	B-
AMERICAN INTERNATIONAL GROUP AIG	169950.0	65	-18	6.1	12.7	289	23	2.9	NA	1.4	0.29	2.07	3.42	3.96	14.0	A+
AMERUS GROUP AMH	1250.1	32	-11	-1.9	5.9	99	18	0.9	NA	0.9	1.25	2.12	3.57	3.97	10.5	NR
AMERUS AOC	4978.9	18	-49	-17.0	8.3	134	16	0.6	8.4	0.9	3.29	0.53	1.60	1.94	12.0	B+
ARKLEY (W.R.) BER	1983.5	40	10	NM	3.4	179	66	0.9	35.4	1.1	0.91	-2.09	2.94	4.31	12.0	B-
ARKSHIRE HATHAWAY BRK.A	110908.2	72300	-4	-23.8	5.1	177	35	2.6	NA	1.8	0.00	521.00	2669.33	3097.67	15.0	B
BUBB CB	10023.1	59	-15	-38.3	2.8	145	54	1.2	33.6	2.8	2.39	0.63	1.77	5.20	12.0	B+
CINCINNATI FINANCIAL CINF	6237.0	39	1	-9.8	3.9	113	29	2.2	26.2	2.3	2.31	1.19	1.71	2.00	10.0	A-
CNA FINANCIAL CNA	5541.0	25	-15	NM	2.1	64	31	0.4	18.9	1.7	0.00	-8.16	1.87	2.71	8.0	C
COMMERCE GROUP CGI	1178.7	36	-4	-0.4	7.6	148	20	1.0	NA	1.1	3.42	2.75	3.17	3.36	10.0	B+
CREST RE GROUP RE	2918.2	58	-18	-8.6	9.2	127	14	1.3	13.8	0.7	0.55	2.10	5.59	6.77	14.5	B
FELITY NATIONAL FINANCIAL FNF	3093.5	32	43	17.5	21.3	147	7	0.7	5.7	0.5	1.48	3.22	5.05	3.68	12.5	B+
FIRST AMERICAN FAF	1478.8	20	9	20.5	15.8	114	8	0.3	4.8	0.6	1.56	2.27	2.79	1.88	12.8	B
FITZPATRICK FINANCIAL SVCS. GROUP HIG	12510.7	49	-22	-20.0	8.2	114	14	0.8	NA	0.9	2.20	2.27	4.58	4.71	12.0	NR
FLORIAN-PILOT JP	5474.1	38	-18	9.7	13.7	156	12	1.6	NA	1.2	3.17	3.33	3.23	3.55	10.0	A+
FIDELITY HANCOCK FINANCIAL SVCS. JHF	8816.4	31	-26	NA	8.3	145	18	1.0	15.4	0.9	1.05	1.99	2.78	3.01	12.0	NR
FIDELITY AMERICA FINANCIAL GROUP LFG	654.9	36	25	3.9	11.2	82	7	0.3	5.9	0.4	0.78	3.24	7.27	3.95	12.0	NR
FIDELITY NATIONAL LNC	6224.6	35	-28	132.4	3.7	116	35	1.3	16.6	1.1	3.81	3.13	2.64	3.10	12.0	B+
FIDELITY LTR	9122.2	40	-27	NM	8.2	82	10	0.5	NA	1.1	1.48	-2.75	5.07	6.32	7.0	B
FIDELITY MKL	1956.6	199	11	NM	0.5	172	NM	1.2	93.7	2.9	0.00	-14.73	4.61	11.91	15.0	C
FIDELITY & McLENNAN MMC	25326.3	47	-12	18.9	23.9	506	22	2.5	NA	1.5	2.37	1.70	2.46	2.77	13.0	A
FIDELITY GENERAL MCY	2146.7	40	-10	-9.1	6.5	196	30	1.3	26.3	1.6	3.04	1.94	2.07	2.74	12.1	B+
FIDELITY MET	18795.5	27	-15	NA	4.1	110	29	0.6	NA	0.9	0.78	0.62	2.56	2.76	12.0	NR
FIDELITY INVESTMENT MTG	4704.5	47	-24	21.1	19.6	141	8	3.1	7.1	0.8	0.21	5.93	5.85	6.03	10.0	A+
FIDELITY GROUP MNY	1109.7	24	-32	NA	-5.5	54	NM	0.5	NA	7.2	1.91	-1.25	0.50	0.33	6.5	NR
FIDELITY FINANCIAL SERVICES NFS	3537.1	30	-29	11.1	2.8	99	42	1.2	NA	0.7	1.76	3.26	3.20	2.89	13.2	NR
FIDELITY CASUALTY OCAS	781.9	13	-20	-3.6	1.1	75	64	0.4	20.3	NM	0.00	1.64	-0.52	1.35	12.0	B
FIDELITY REPUBLIC INTERNATIONAL ORI	3606.9	30	7	7.1	12.7	118	9	1.4	NA	0.8	2.14	2.88	3.22	3.40	11.0	A-
FIDELITY RENEWAL PRE	2546.2	51	-6	NM	5.9	136	24	1.1	18.5	1.0	2.27	-4.16	3.62	6.13	14.0	NR
FIDELITY PNK	778.8	8	-55	NA	-5.3	38	NM	0.3	NA	NM	1.94	-1.31	-0.65	0.52	12.0	NR
FIDELITY PROGRESSIVE PGR	12330.5	57	14	0.1	18.1	349	20	1.4	17.0	1.2	0.18	1.83	3.26	3.55	14.0	B+
FIDELITY PROTECTIVE LIFE PL	2025.8	30	2	6.3	10.1	118	12	1.1	10.8	1.0	2.03	2.01	2.56	2.80	11.0	A
FIDELITY FINANCIAL PRU	17158.7	30	-9	NA	-0.7	79	NA	0.6	NA	1.4	1.33	NA	2.12	2.44	10.0	NR
INSURANCE GROUP OF AMERICA RGA	1352.7	27	-18	-19.3	6.1	115	19	0.6	NA	0.8	0.88	0.80	2.75	3.07	13.0	B+
RECO SAFC	4625.1	36	16	NM	6.2	114	18	0.7	13.7	1.9	2.04	-8.18	1.88	2.53	10.0	B-
RECO PAUL SPC	8434.2	37	-15	NM	-13.2	155	NM	0.9	NM	2.9	3.11	-4.84	1.27	3.79	10.0	B+
RECO FINANCIAL GROUP SFG	1563.4	53	12	NA	9.3	139	15	0.9	11.7	1.0	0.76	3.44	4.13	4.74	13.0	NR
RECO INFORMATION SERVICES STC	366.9	21	5	28.0	15.1	81	5	0.2	4.1	0.4	0.00	2.98	4.17	2.64	12.0	B
RECO MARK TMK	4398.7	37	-6	13.7	13.2	159	12	1.6	NA	1.1	0.97	3.11	3.52	3.85	10.0	A
RECO ATLANTIC HOLDINGS TRH	3630.1	69	-24	-43.7	8.9	178	20	1.5	19.9	1.3	0.58	0.36	4.51	5.31	11.5	A-
RECO VELERS PROPERTY CASUALTY TAP.B	16051.5	16	NA	NA	11.8	144	11	1.2	NA	0.9	0.00	1.38	1.41	1.62	12.0	NR
RECO IMPROVIDENT UNM	4117.6	17	-36	-2.1	6.1	62	10	0.4	NA	0.7	3.46	2.39	2.53	2.57	10.0	B+
RECO CAPITAL XL	11999.3	83	-9	NM	1.7	202	123	1.9	103.1	1.3	2.27	-4.55	5.13	8.06	12.5	B
REAL ESTATE																
INDUSTRY GROUP AVERAGE	6942.9	31	-7	-4.7	5.7	164	22	2.9	NA	NA	7.43	1.01	1.40	1.43	NA	
RECO INVESTMENT & MGMT. AIV	3482.7	37	-18	-32.5	3.5	152	27	2.2	NA	NA	8.78	0.23	1.61	1.72	NA	NR
RECO CITY OFFICE PROPERTIES TRUST EOP	10764.0	26	-15	7.7a	5.7	103	17	2.9	NA	NA	7.78	1.58	1.67	1.50	NA	NR
RECO CITY RESIDENTIAL EQR	7205.2	26	-9	11.1	5.2	164	25	3.5	NA	NA	6.62	1.36	1.09	0.85	NA	NR
RECO COMMON PROPERTY GROUP SPG	6319.5	34	15	-5.3	8.4	238	21	2.9	NA	NA	6.52	0.86	1.25	1.65	NA	NR
HEALTH CARE																
INDUSTRY GROUP AVERAGE	17467.0	34	-9	18.8	20.6	485	26	2.1	14.4	1.2	0.52	0.86	1.95	2.18	15.9	

													ESTIMATES FROM ANALYSTS				
COMPANY	STOCK SYMBOL (FY)	MARKET VALUE	RECENT SHARE PRICE	2002 PRICE CHANGE %	EARNINGS GROWTH 1997-2001 %	RETURN ON EQUITY	PRICE AS % OF BOOK VALUE	P-E RATIO	PRICE-SALES RATIO	PRICE-CASH FLOW RATIO	P-E TO GROWTH RATE	YIELD %	2001 ACTUAL	2002 ANALYST EST.	CONSENSUS	LONG-TERM GROWTH RATE %	S&P EQU RANK
14 HEALTH CARE EQUIPMENT & SERVICES																	
INDUSTRY GROUP AVERAGE		5981.5	30	-7	18.8	20.1	442	21	1.3	12.5	1.1	0.31	0.69	1.94	2.18	15.9	
(A) HEALTH CARE EQUIPMENT & SUPPLIES																	
INDUSTRY AVERAGE		11146.7	37	-8	17.8	27.4	722	29	3.5	16.9	1.7	0.66	1.14	1.70	1.94	14.2	
APPLIED BIOSYSTEMS GROUP	ABI (6)	4573.4	22	-44	2.6a	14.9	400	27	2.8	17.7	1.9	0.78	0.96	0.78*	0.90	15.0	B
BARO (C.R.)	8CR	2867.0	56	-14	21.9	17.4	338	20	2.3	14.9	1.4	1.59	2.75	3.34	3.76	12.0	B
BAUSCH & LOMB	80L	2035.4	38	0	-8.6	5.3	204	39	1.1	12.6	2.0	1.38	0.78	1.68	2.03	11.0	B
BAXTER INTERNATIONAL	BAX	19314.3	32	-40	14.0	15.9	443	29	2.4	17.0	1.1	1.82	1.09	1.99	2.25	15.0	B
BECKMAN COULTER	BEC	1829.8	30	-33	NM	23.5	286	13	0.9	6.9	1.2	1.22	2.21	2.38	2.61	10.0	B
BECTON, DICKINSON	80X (9)	7616.9	30	-10	18.1	19.0	306	17	1.9	9.8	1.7	1.35	1.63	1.79*	2.07	10.0	A
BIOMET	BMET (5)	7144.1	28	-11	16.1	22.1	633	29	5.8	24.8	1.7	0.36	0.88	1.08	1.25	15.0	A
BOSTON SCIENTIFIC	BSX	17129.3	42	74	NM	14.6	749	52	6.2	NA	2.8	0.00	-0.13	0.99	1.26	15.0	B
FISHER SCIENTIFIC INTERNATIONAL	FSH	1636.2	30	3	NM	82.8	1676	21	0.5	10.2	1.1	0.00	0.31	1.76	2.12	15.0	B
GUIDANT	GDT	9176.3	30	-40	39.1	29.8	418	14	3.0	11.7	0.9	0.00	1.58	2.15	1.93	15.0	N
MEOTRONIC	MDT (4)	56988.3	47	-9	12.3	18.1	794	44	8.2	NA	2.1	0.53	0.80	1.41	1.64	16.0	A
ST. JUDE MEDICAL	STJ	6173.5	35	-10	35.1	17.2	418	25	4.0	19.6	1.5	0.00	0.97	1.50	1.72	15.0	B
STRYKER	SYK	12233.9	62	6	20.7	23.3	887	39	4.2	28.3	1.8	0.19	1.34	1.73	2.08	20.0	B
ZIMMER HOLDINGS	ZMH	7336.0	38	23	24.5	79.9	2561	32	5.6	29.0	2.0	0.00	0.77	1.28	1.49	15.0	N
(B) HEALTH CARE PROVIDERS & SERVICES																	
INDUSTRY AVERAGE		4338.1	28	-7	19.2	17.7	351	19	0.6	11.1	1.0	0.20	0.55	2.01	2.26	16.4	
ADVANCEPCS	ADVP (3)	2214.8	25	-16	65.6	16.4	247	17	0.2	11.8	0.7	0.00	1.23	1.68	2.06	22.5	N
AETNA	AET	5682.9	38	14	NM	1.3	74	69	0.3	NA	1.3	0.11	-2.03	2.08	3.06	14.0	N
AMERISOURCEBERGEN	ABC (9)	6142.5	58	-9	37.5	10.4	185	18	0.1	15.1	0.9	0.17	2.10	3.16*	3.95	20.0	N
ANTHEM	ATH	8368.7	59	20	44.0	8.7	157	15	0.7	NA	1.0	0.00	3.30	4.08	4.74	15.0	N
BEVERLY ENTERPRISES	BEV	341.9	3	-62	NM	-76.2	107	NM	0.1	NM	0.7	0.00	-2.90	0.39	0.34	12.5	C
CAROLINA HEALTH	CAH (6)	27286.8	62	-5	22.8	18.4	429	24	0.5	19.3	1.3	0.16	1.88	2.45*	3.19	20.0	A
CAREMARK RX	CMX	4031.0	18	8	41.0	NM	NM	17	0.6	13.2	0.6	0.00	0.73	1.15	1.46	25.0	N
CIGNA	CI	6095.5	44	-53	16.0	-5.7	137	NM	0.3	NM	0.5	3.03	6.59	6.56	5.80	13.5	A
COBALT	C8Z	504.3	12	90	NM	10.2	177	18	0.3	11.8	0.5	0.00	-0.58	1.15	0.98	20.0	N
COMMUNITY HEALTH SYSTEMS	CYH	2030.4	21	-19	NM	8.0	171	22	1.0	9.5	0.8	0.00	0.54	1.03	1.23	25.0	N
COVENTRY HEALTH CARE	CVH	1721.2	29	44	37.6	20.0	269	14	0.5	11.6	0.8	0.00	1.23	2.36	2.74	15.0	B
O&K HEALTHCARE RESOURCES	OKWD (6)	133.7	9	-68	25.9	12.3	81	7	0.1	5.5	0.3	0.65	1.01	1.42*	1.32	19.5	E
OAVITA	OVA	1590.0	26	5	28.9	329.4	3264	13	0.9	6.8	1.0	0.00	1.51	1.79	2.08	15.0	N
EXPRESS SCRIPTS	ESRX	3957.6	51	8	33.1	18.6	408	22	0.3	14.7	0.9	0.00	1.56	2.55	3.17	23.0	E
GENESIS HEALTH VENTURES	GHVI (9)	710.1	18	-19	NM	7.7	78	10	0.3	5.0	NA	0.00	-25.65	1.76*	1.58	15.0	N
GENTIVA HEALTH SERVICES	GTIV	216.6	8	-63	-8.9	-46.9	201	NM	0.2	NM	3.4	0.00	0.85	0.24	0.49	10.0	N
HCA	HCA	20593.3	40	4	57.4	17.3	359	21	1.1	10.2	1.0	0.20	1.68	2.67	3.13	15.0	E
HEALTH MGMT. ASSOCIATES	HMA (9)	4231.7	18	-5	16.7	18.3	314	18	1.9	12.4	1.2	0.46	0.76	0.97*	1.13	15.0	E
HEALTH NET	HNT	3195.6	26	19	NM	18.5	237	13	0.3	10.4	0.9	0.00	0.69	2.19	2.46	13.5	E
HEALTHSOUTH	HRC	1609.2	4	-73	-14.0	7.2	41	6	0.4	2.6	0.4	0.00	0.51	0.76	0.61	15.0	E
HUMANA	HUM	1741.3	10	-12	-9.5	10.8	104	10	0.2	5.6	0.7	0.00	0.70	1.19	1.38	13.0	E
IMS HEALTH	RX	4671.2	17	-15	-4.7	102.2	2805	28	3.4	20.1	1.2	0.48	0.46	0.98	1.07	14.0	N
KINDRED HEALTHCARE	KINO	294.0	17	-68	NA	7.4	47	7	0.1	2.5	0.7	0.00	5.27	2.23	1.76	10.0	N
LABORATORY CORP. OF AMERICA	HLDG. LH	3545.1	24	-41	NM	15.4	225	14	1.5	10.3	0.7	0.00	1.30	1.83	2.19	20.0	B
MANOR CARE	HCR	1891.5	19	-18	-17.4	8.8	183	21	0.7	8.7	0.9	0.00	0.66	1.40	1.47	15.0	N
McKESSON	MCK (3)	7545.9	26	-31	9.0	11.4	180	16	0.1	NA	0.7	0.93	1.43	1.88	2.28	20.0	N
MIO ATLANTIC MEDICAL SERVICES	MME	1483.7	31	37	47.8	23.2	446	17	0.7	16.8	1.0	0.00	1.41	2.00	2.36	15.0	E
OMNICARE	OCR	2035.4	22	-13	6.2	8.9	164	18	0.8	12.4	0.9	0.42	0.79	1.48	1.77	17.0	A
OWENS & MINOR	OMI	562.9	17	-11	10.7	16.8	213	14	0.1	9.1	1.0	1.94	0.85	1.28	1.39	12.5	E
OXFORD HEALTH PLANS	OHP	3193.6	37	21	NM	43.3	571	14	0.7	12.0	0.7	0.00	3.21	3.51	3.94	15.0	E
PACIFICARE HEALTH SYSTEMS	PHSY	955.4	27	67	NM	5.9	74	13	0.1	5.6	0.6	0.00	0.53	3.85	4.16	12.0	E
PATTERSON DENTAL	POCO (4)	2864.4	42	3	22.8	18.4	501	27	1.9	24.1	1.3	0.00	1.40	1.71	2.01	19.0	E
PSS WORLD MEDICAL	PSSI (3)	482.7	7	-15	-14.1	3.2	184	58	0.3	18.0	1.6	0.00	0.12	0.29	0.40	15.0	N
QUEST DIAGNOSTICS	DGX	5452.8	56	-22	NM	17.4	325	19	1.4	12.7	0.7	0.00	1.88	3.19	4.00	25.0	N
QUINTILES TRANSNATIONAL	QTRN	1383.0	12	-27	NM	8.8	92	11	0.9	6.2	1.0	0.00	-1.49	0.67	0.79	18.0	E
SCHEIN (HENRY)	HSIC	1870.0	43	15	NM	13.9	228	17	0.7	13.0	1.1	0.00	2.01	2.60	2.97	15.0	N
SERVICE CORP. INTERNATIONAL	SRV	981.8	3	-33	NM	-53.6	76	NM	0.4	NM	3.4	0.00	-2.09	0.39	0.41	2.5	C
SIERRA HEALTH SERVICES	SIE	329.1	11	38	-10.7	23.2	214	10	0.2	5.7	0.6	0.00	0.61	1.33	1.55	15.0	C
TENET HEALTHCARE	THC (5)	8989.1	18	-53	26.4	19.4	153	8	0.6	5.6	0.4	0.00	2.04	2.55	2.06	16.8	E
TRIAO HOSPITALS	TRI	2247.3	30	3	NM	6.1	118	19	0.7	7.9	0.8	0.00	0.10	1.79	2.19	20.0	N
UNITEOHEALTH GROUP	UNH	24615.3	81	15	26.2	28.0	564	21	1.0	16.7	1.1	0.04	2.79	4.20	5.05	18.0	A
UNIVERSAL HEALTH SERVICES	UHS	2705.2	45	5	12.7	14.1	286	22	0.9	10.5	0.9	0.00	1.62	2.70	3.15	19.0	E
US ONCOLOGY	USON	781.1	9	14	28.3	-3.2	130	NM	0.5	14.4	1.0	0.00	0.46	0.59	0.66	15.0	N
WELLPOINT HEALTH NETWORKS	WLP	9594.8	66	13	18.4	16.6	254	15	0.6	NA	1.0	0.00	3.15	4.39	5.09	15.0	E

15 PHARMACEUTICALS & BIOTECHNOLOGY

INDUSTRY GROUP AVERAGE		59101.8	47	-18	19.0	22.6	639	43	5.0	22.7	1.6	1.31	1.47	2.01	2.16	16.3	
(A) BIOTECHNOLOGY																	
INDUSTRY AVERAGE		38754.7	40	-28	3.4	-4.6	332	NM	9.7	51.9	1.7	0.00	0.66	1.14	1.36	21.0	
AMGEN	AMGN	60524.6	47	-16	15.1	-9.5	343	NM	12.4	NM	1.7	0.00	1.03	1.37	1.65	20.0	E

EARNINGS PER SHARE

COMPANY STOCK SYMBOL (FY)	MARKET VALUE	RECENT SHARE PRICE	2002 PRICE CHANGE %	EARNINGS GROWTH 1997-2001 %	RETURN ON EQUITY	PRICE AS % OF BOOK VALUE	P-E RATIO	PRICE-SALES RATIO	PRICE-CASH FLOW RATIO	P-E TO GROWTH RATE	YIELD %	ESTIMATES FROM ANALYSTS				
												2001 ACTUAL	2002 ANALYST EST	CONSENSUS	LONG-TERM GROWTH RATE %	S&P EQUITY RANKING
INVENTECH DNA	16984.9	33	-39	3.6	0.2	320	NM	7.0	51.9	1.6	0.00	0.29	0.92	1.08	22.0	NR
3) PHARMACEUTICALS																
INDUSTRY AVERAGE	62008.6	48	-16	20.7	26.5	683	43	4.3	19.8	1.6	1.50	1.59	2.13	2.28	15.6	
BOTT LABORATORIES ABT	68408.0	44	-21	-7.1	26.4	649	25	4.0	17.1	1.6	2.15	0.99	2.07	2.29	13.0	A
BERGAN AGN	7606.5	59	-22	15.1	11.3	1031	93	5.1	NA	1.4	0.61	1.69	1.88	2.30	23.0	B+
BARR LABORATORIES BRL (6)	2896.3	66	-17	89.3	25.5	406	17	2.7	NA	0.6	0.00	1.40	4.63*	3.75	23.5	8
BISTOL-MYERS SQUIBB BMY	51354.5	27	-48	-1.5	2.1	479	221	2.9	25.6	2.4	4.23	1.29	1.21	1.64	9.0	A
BEST LABORATORIES FRX (3)	19344.1	107	31	69.5	23.4	1004	44	10.5	41.4	1.3	0.00	1.82	2.98	3.62	27.0	B+
AX WX	2629.1	14	-33	NM	22.0	426	20	2.2	13.5	1.0	0.00	1.15	0.58	0.77	22.5	B-
HNSON & JOHNSON JNJ	169278.7	57	-4	NA	28.6	766	28	4.8	NA	1.7	1.44	1.84	2.26	2.62	14.5	A+
LLY (ELI) LLY	76726.4	68	-13	9.3	31.0	929	29	7.0	25.3	2.4	1.82	2.58	2.55	2.65	11.0	B+
ERCK MPK	133451.4	59	1	13.4	40.6	761	19	2.6	15.5	1.9	2.42	3.14	3.13	3.37	10.0	A+
IZER PFE	194293.0	32	-21	27.0	45.6	1025	23	5.7	19.9	1.2	1.65	1.22	1.58	1.84	16.5	A+
IARMACIA PHA	54690.4	42	-1	NA	26.3	723	27	3.9	NA	1.8	1.28	0.97	1.55	1.78	15.0	8
CHERING-PLOUGH SGP	33242.2	23	-37	7.9	22.6	417	18	3.2	15.4	1.8	3.00	1.32	1.57	1.05	8.0	A-
ATSON PHARMACEUTICALS WP	3204.9	30	-4	2.7	10.2	182	18	2.7	12.0	1.4	0.00	1.07	1.62	1.75	13.4	8
YETH WYE	50994.2	38	-37	2.0a	54.9	758	14	3.5	12.0	1.4	2.39	1.72	2.21	2.46	12.0	B
INDUSTRIALS																
CTOR AVERAGE	7238.3	29	-10	2.9	10.5	270	28	0.9	13.5	1.8	1.19	0.42	0.96	1.57	12.9	
CAPITAL GOODS																
DUSTRY GROUP AVERAGE	9223.0	34	-9	1.2	12.0	253	22	0.8	10.7	1.6	1.50	1.27	1.80	2.24	12.2	
4) AEROSPACE & DEFENSE																
DUSTRY AVERAGE	11162.7	42	-6	-2.5	15.0	232	17	0.9	11.1	1.3	1.51	2.08	2.78	2.76	12.5	
LIANT TECHSYSTEMS ATK (3)	2252.1	59	15	13.5	17.5	370	21	1.1	13.5	1.3	0.00	2.45	3.24	3.61	14.0	NR
ING BA	27212.9	34	-12	NM	16.8	250	15	0.5	7.8	0.8	2.00	3.41	2.83	2.22	15.0	8
NCORP G (11)	348.3	8	-43	3.1	35.5	101	3	0.3	1.8	3.4	1.48	3.00	0.37	0.71	6.5	8
ERAL DYNAMICS GD	16366.0	81	2	13.8	19.6	320	16	1.2	13.1	1.3	1.47	4.65	5.18	5.48	12.0	B+
ODRICH GP	1878.8	18	-31	NA	10.1	184	19	0.5	NA	0.7	4.35	1.65	2.30	1.96	11.0	B+
NEYWELL INTERNATIONAL HON	21355.5	26	-23	NM	13.2	206	16	1.0	10.2	0.9	2.83	-0.12	2.02	1.76	15.0	B+
COMMUNICATIONS HOLDINGS LLL	4241.8	45	0	32.6a	8.2	195	23	1.2	17.2	1.0	0.00	1.48	2.26	2.68	20.0	NR
CKHEED MARTIN LMT	23807.4	52	12	NM	9.9	309	31	0.9	17.1	2.0	0.84	0.18	2.55	2.60	10.0	B-
RTHROP GRUMMAN NOC	10966.7	97	-4	0.4	7.4	146	18	0.7	NA	1.7	1.65	4.80	5.66	5.22	10.0	B
ECISION CASTPARTS PCP (3)	1286.0	25	-13	-17.6	6.9	123	18	0.5	NA	0.9	0.49	0.81	2.88	2.63	10.0	A-
YTHEON RTN	11839.8	29	-10	-85.1a	6.1	109	18	0.7	10.7	1.1	2.74	0.01	2.13	1.69	12.0	8
CKWELL COLLINS COL (9)	3929.0	21	10	NA	23.9	398	17	1.6	11.5	1.4	1.68	NA	1.28*	1.34	12.0	NR
ITED DEFENSE INDUSTRIES UD	1203.2	23	11	NM	NM	NM	11	0.7	9.3	1.1	0.00	0.86	1.82	2.04	12.0	NR
ITED TECHNOLOGIES UTX	29589.8	62	-3	19.7	20.0	306	15	1.1	10.1	0.9	1.57	3.83	4.40	4.69	15.0	A-
BUILDING PRODUCTS																
DUSTRY AVERAGE	3424.9	31	-11	1.8	49.2	801	15	0.5	7.8	1.0	1.12	1.64	2.42	2.75	12.6	
ERICAN STANDARD ASD	5390.0	74	9	8.1	199.1	3381	17	0.7	10.1	1.2	0.00	4.04	5.04	5.65	12.5	NR
FFON GFF (5)	413.3	12	-17	4.3	11.5	140	13	0.3	6.7	1.3	0.00	0.92	0.97*	1.23	10.0	B
SCO MAS	5948.7	20	-18	-20.0	11.5	186	16	1.1	NA	0.9	2.78	0.42	1.54	1.80	15.0	8
IVERSAL FOREST PRODUCTS UFP	383.4	22	3	14.7	13.9	148	11	0.2	6.3	0.8	0.42	1.63	1.95	2.28	14.5	A-
ARK INTERNATIONAL YRK	989.3	25	-34	1.8	9.9	150	15	0.3	8.1	0.9	2.39	1.17	2.60	2.78	11.0	B
CONSTRUCTION & ENGINEERING																
DUSTRY AVERAGE	762.8	19	-29	31.3	6.3	130	13	0.2	7.7	1.1	0.42	1.13	1.37	1.64	13.2	
OR GROUP EME	734.2	53	17	43.9	12.6	156	14	0.2	9.7	0.9	0.00	3.40	4.07	4.73	15.0	NR
OR FLR	2204.0	27	-27	38.2	18.0	254	14	0.2	NA	1.1	2.33	1.61	2.12	2.23	12.0	B
ANITE CONSTRUCTION GVA	703.5	17	-29	16.1	11.2	158	14	0.4	6.7	1.4	1.88	1.24	1.09	1.32	11.0	A-
TEGRATED ELECTRICAL SERVICES IES (5)	154.5	4	-24	NM	3.9	61	16	0.1	5.8	1.6	0.00	0.70	0.25*	0.57	10.0	NR
OBBS ENGINEERING GROUP JEC (9)	1974.8	36	10	17.6	15.9	286	18	0.4	14.2	1.2	0.00	1.61	1.98*	2.28	15.0	B+
STEC MTZ	192.4	4	-42	NM	-3.4	50	NM	0.2	6.6	2.2	0.00	-1.93	0.12	0.31	15.0	B
DERMOTT INTERNATIONAL MDP	210.2	3	-73	NM	NM	98	NM	0.1	NM	NM	0.00	-0.34	-1.05	0.17	NA	C
ANTA SERVICES PWR	227.4	4	-76	39.9	-27.7	39	NM	0.1	NM	0.8	0.00	1.10	0.33	0.33	14.0	NR
AW GROUP SGR (8)	706.6	17	-26	38.8	14.2	102	8	0.2	5.6	0.5	0.00	1.46	2.25*	1.93	15.0	B+
S UPS VICI	520.9	21	-24	24.8	11.7	101	8	0.2	5.1	0.7	0.00	2.41	2.51	2.59	12.0	B+
ELECTRICAL EQUIPMENT																
DUSTRY AVERAGE	3898.0	24	7	-3.2	7.3	229	20	1.0	12.0	1.5	2.47	0.67	1.43	1.57	12.1	
ITY BRANDS AY (8)	561.5	14	12	NA	12.9	140	11	0.3	5.5	1.1	4.42	0.99	1.26*	1.23	10.0	NR
ERICAN POWER CONVERSION APCC	3156.3	16	11	-2.4	9.2	247	27	2.4	18.7	1.9	0.00	0.58	0.67	0.75	12.5	B+
PER INDUSTRIES CBE	3503.7	38	9	1.3	12.1	171	14	0.9	9.1	1.3	3.68	2.75	2.60	3.01	11.0	B+
ERSON ELECTRIC EMR (9)	21958.0	52	-9	-0.9	18.5	382	21	1.6	13.7	1.9	3.01	2.40	2.52*	2.68	11.0	A+
RGIZER HOLDINGS EMR (9)	2685.1	30	55	0.0	26.4	381	15	1.5	NA	1.5	0.00	-0.42	2.01*	2.22	10.0	NR
ERAL CABLE BGC	142.5	4	-67	13.8	-8.1	155	NM	0.1	NA	1.7	4.65	1.13	0.18	0.24	14.0	NR
BELL -UB B	2123.6	36	22	-19.1	9.1	286	32	1.5	18.1	2.1	3.67	0.82	1.71	2.05	10.0	B+
NUFACTURERS SERVICES MSV	166.2	5	-19	NM	26.9	163	NM	0.2	NM	1.0	0.00	-2.86	0.28	0.27	17.5	NR
CKWELL AUTOMATION PCK (9)	3911.1	21	18	NM	14.0	243	18	1.0	9.5	1.6	3.14	0.68	1.20*	1.10	11.0	B+

INVESTMENT OUTLOOK SCOREBOARD

EARNINGS PER SHARE

COMPANY	STOCK SYMBOL (FY)	MARKET VALUE	RECENT SHARE PRICE	2002 PRICE CHANGE %	EARNINGS GROWTH 1997-2001 %	RETURN ON EQUITY	PRICE AS % OF BOOK VALUE	P-E RATIO	PRICE-SALES RATIO	PRICE-CASH FLOW RATIO	P-E TO GROWTH RATE	YIELD %	ESTIMATES FROM ANALYSTS				S&P EQUITY RANKING
													2001 ACTUAL	2002 ANALYST EST.	CONSENSUS	LONG-TERM GROWTH RATE %	
SMITH (A.O.) AOS		771.7	27	37	-14.8	5.7	126	21	0.6	9.1	1.1	2.10	0.61	1.84	2.14	13.5	B
(E) INDUSTRIAL CONGLOMERATES																	
INDUSTRY AVERAGE		52191.3	45	-13	-3.4	14.4	293	16	1.2	9.7	1.3	1.82	1.90	2.20	2.89	12.4	
CARLISLE CSL		1270.0	42	12	-23.1	11.0	215	19	0.7	10.9	1.6	2.07	0.82	2.34	2.74	11.0	A+
GENERAL ELECTRIC GE		269872.7	27	-32	14.4	25.6	433	17	2.1	11.4	1.3	2.65	1.41	1.51	1.63	13.5	A+
TELEFLEX TFX		1727.1	44	-7	11.0	13.6	197	15	0.9	8.3	1.0	1.64	2.86	3.08	3.33	14.0	A+
TEXTRON TXT		5919.6	43	4	-15.1	14.5	176	12	0.5	7.1	1.2	3.02	1.16	2.98	3.29	12.0	A-
3M MMM		50667.1	130	10	-8.3	27.8	763	28	3.2	17.7	2.2	1.91	3.58	5.25	5.88	11.5	A-
TYCO INTERNATIONAL TYC (9)		35418.8	18	-70	NM	-10.8	143	NM	1.0	NA	NM	0.28	2.55	-1.40*	1.58	15.0	B-
WALTER INDUSTRIES WLT		463.7	10	-8	0.8	19.2	125	7	0.2	3.1	0.6	1.15	0.95	1.63	1.80	10.0	NR
(F) MACHINERY																	
INDUSTRY AVERAGE		4122.8	36	-7	-4.2	7.1	213	30	0.8	11.6	2.1	1.48	0.91	1.42	2.20	11.8	
AGCO AG		1802.0	24	53	-41.1	5.7	228	40	0.6	17.5	2.2	0.00	0.34	1.10	1.62	10.0	B-
BRIGGS & STRATTON BGG (6)		912.1	42	-1	-3.7	14.5	209	16	0.6	7.0	3.0	3.04	2.21	2.36*	3.10	6.0	B+
CATERPILLAR CAT		17174.6	50	-4	-14.7	11.0	287	26	0.9	9.2	2.0	2.81	2.32	2.10	2.54	12.0	B+
CRANE CR		1230.3	21	-20	-0.5	12.3	176	14	0.8	8.5	1.8	1.94	1.47	1.46	1.61	8.0	A-
CUMMINS CUM		1219.9	31	-18	NM	2.5	116	51	0.2	5.0	9.2	3.82	-2.66	0.43	1.94	8.0	B-
DANAHER DHR		9577.4	63	4	11.3	11.6	332	29	2.3	NA	1.5	0.16	2.01	2.71	3.17	15.0	A-
DEERE DE (10)		12183.9	51	17	-24.8	7.6	291	38	0.9	NA	3.8	1.72	-0.27	1.33*	2.45	10.0	B
DOVER DOV		6286.1	31	-16	NA	4.7	267	56	1.5	21.4	2.1	1.74	0.82	1.13	1.51	13.0	A-
EATON ETN		5348.8	76	2	-22.8	9.4	205	22	0.8	7.6	1.7	2.32	2.39	4.35	5.02	10.0	B+
FLOWSERVE FLS		833.0	15	-43	-24.0	7.9	110	12	0.4	6.6	0.7	0.00	0.42	1.48	1.64	15.0	B-
HARSCO HSC		1252.4	31	-10	-3.3	9.9	166	17	0.6	5.4	1.2	3.40	1.79	2.24	2.32	12.0	B+
ILLINOIS TOOL WORKS ITW		20834.4	68	0	NA	13.7	321	24	2.2	NA	1.6	1.35	2.62	3.01	3.38	14.5	A+
INGERSOLL-RAND IR		7816.4	46	11	-9.8	10.5	217	21	0.8	NA	1.4	1.47	1.48	2.84	3.19	12.0	A
ITT INDUSTRIES ITT		5531.5	60	19	122.7	17.0	315	19	1.1	11.7	1.4	1.00	2.39	3.67	3.99	12.0	NR
KENAMETAL KMT (6)		1225.3	35	-13	-17.0	5.1	170	31	0.8	11.1	2.3	1.95	1.75	1.22*	1.98	12.5	B-
MILACRON MZ		225.4	7	-58	NM	-9.7	54	NM	0.3	NM	NM	0.60	-1.08	-0.50	0.04	9.5	B
NAVISTAR INTERNATIONAL NAV (10)		1867.0	31	-22	NM	NM	756	NM	0.3	NA	NM	0.00	-0.15	-7.88*	0.04	7.5	B-
OSHKOSH TRUCK OSK (9)		1052.8	62	27	28.7	14.5	257	18	0.6	12.4	1.2	0.56	2.98	3.45*	3.89	15.0	B+
PACCAR PCAR		5679.1	49	12	-15.4	11.8	223	19	0.8	NA	2.3	1.63	1.51	2.67	2.65	8.0	B+
PALL PLL (7)		2342.9	19	-21	-5.4	3.9	297	80	1.7	NA	2.3	1.89	0.95	0.59*	1.06	14.0	B
PARKER HANNIFIN PH (6)		5511.2	47	2	-21.1	5.0	211	42	0.9	15.2	3.5	1.54	2.99	1.12*	2.23	12.0	A-
PENTAIR PNR		1760.8	36	-2	-11.9	7.8	160	21	0.7	12.2	1.0	2.13	1.17	2.59	3.00	14.0	A-
RELIANCE STEEL & ALUMINUM RS		720.8	23	-14	-3.1	5.3	118	22	0.4	11.6	1.3	1.06	1.28	1.14	1.88	15.0	N
SPX SPW		3800.8	47	-31	-6.5	14.6	210	15	0.8	9.3	0.7	0.00	2.34	4.39	4.78	15.0	B-
STEWART & STEVENSON SVCS. SVC (1)		318.8	11	-41	NM	3.9	84	22	0.3	NA	0.9	3.04	1.57	0.72	1.20	17.0	B
TEREX TEX		584.6	12	-30	-21.4	3.4	76	20	0.2	10.6	0.8	0.00	0.58	1.11	1.59	14.5	B-
TIMKEN TKR		1256.8	20	23	NM	2.0	153	74	0.5	7.6	2.3	2.62	-0.69	0.86	1.29	10.0	B
TRINITY INDUSTRIES TRN		896.4	20	-28	NA	-5.9	87	NM	0.5	30.5	NM	1.23	-0.90	-0.15	1.00	10.0	B
UNOVA UNA		315.2	5	-7	NM	-2.4	73	NM	0.2	12.1	NM	0.00	-5.14	-0.20	-0.31	11.0	N
(G) TRADING COMPANIES & DISTRIBUTORS																	
INDUSTRY AVERAGE		2631.1	36	4	-9.5	9.6	210	24	0.6	14.0	2.1	2.00	1.63	1.62	1.83	11.0	
APPLIED INDUSTRIAL TECHNOLOGIES AIT (6)		344.8	18	-3	-13.9	4.6	115	25	0.2	12.2	2.4	2.67	1.41	0.76*	0.87	10.0	B-
GRAINGER (W.W.) GWW		4917.5	54	12	-5.0	14.5	305	22	1.1	15.7	1.8	1.34	1.84	2.48	2.79	12.0	A
17 COMMERCIAL SERVICES & SUPPLIES																	
INDUSTRY GROUP AVERAGE		4908.6	25	-13	5.3	12.2	345	31	1.4	14.9	2.0	0.96	0.79	1.25	1.46	15.1	
ABM INDUSTRIES ABM (10)		729.7	15	-5	4.7	12.1	189	16	0.3	14.0	1.3	2.43	0.65	0.92*	1.05	12.5	A
ADMINISTAFF ASF		189.6	7	-75	7.9	-2.5	165	NM	0.0	10.7	NM	0.00	0.36	-0.03	0.31	25.0	B
ALLIED WASTE INDUSTRIES AW		2103.2	11	-24	-61.8	5.4	294	19	0.4	2.9	0.8	0.00	0.01	0.91	1.02	15.0	B-
ARAMARK RMK (9)		4291.7	23	-15	25.6	31.5	500	17	0.5	8.2	1.2	0.00	0.97	1.34*	1.35	14.0	N
AUTOMATIC DATA PROCESSING ADP (6)		26033.0	43	-26	15.2	23.5	548	24	2.6	18.7	1.8	1.10	1.44	1.75*	1.85	14.0	A-
AVERY DENNISON AVY		6347.7	64	14	5.8	25.5	622	25	1.6	15.5	1.9	2.23	2.47	2.82	3.14	12.0	A-
BANTA BN		776.3	31	4	8.8	12.9	169	13	0.6	5.8	1.4	2.09	2.01	2.35	2.49	9.5	B-
BLOCK (H&R) HRB (4)		6925.8	38	-14	28.2	40.5	629	16	2.0	11.5	0.8	1.88	2.31	3.21	3.20	15.0	A
CDI CDI		555.3	29	51	NM	-6.8	185	NM	0.4	75.4	2.3	0.00	-0.82	0.85	1.45	15.0	B
CENDANT CD		13039.0	13	-36	46.6	4.9	143	31	1.0	14.3	0.7	0.00	0.36	1.27	1.59	15.0	B-
CERIDIAN CEN		2140.0	14	-23	NM	7.4	180	25	1.8	12.1	1.2	0.00	0.33	0.76	0.89	16.0	B-
CINTAS CTAS (5)		8587.1	50	5	13.6	16.1	578	36	3.6	24.8	1.8	0.50	1.36	1.57	1.86	18.0	A
CONCORD EFS CE		7638.6	15	-54	30.9	14.0	355	26	3.7	19.6	1.0	0.00	0.42	0.69	0.83	22.0	B-
CONVERGYS CVG		2701.5	17	-54	8.6	19.8	232	13	1.2	7.6	0.9	0.00	0.80	1.35	1.26	15.0	N
DAISYTEK INTERNATIONAL DZTK (3)		154.6	8	-36	-11.1	-10.5	89	NM	0.1	NM	1.1	0.00	0.69	0.60	1.05	13.0	N
DONNELLEY (R.R.) DNY		2410.5	21	-28	-38.0	6.6	284	43	0.5	6.9	1.7	4.70	0.21	1.41	1.56	9.0	N
DST SYSTEMS DST		4542.6	38	-24	31.6	16.1	341	22	2.1	12.4	1.2	0.00	1.81	1.77	1.98	18.0	N
DUN & BRADSTREET DNB		2621.4	35	0	15.4	NM	NM	21	2.1	12.0	1.2	0.00	1.88	2.15	2.46	14.0	N
FIRST DATA FDC		26052.7	35	-12	29.0	28.8	662	23	3.8	NA	1.4	0.23	1.10	1.66	1.90	15.0	B-
FISERV FISV		6502.3	34	-20	20.9	14.2	368	27	2.7	18.8	1.3	0.00	1.09	1.36	1.59	19.0	B-
GEVITY HR GVHR		83.5	4	58	NM	3.6	143	40	0.0	7.5	1.2	4.98	-0.76	0.22	0.28	15.0	N
HEWITT ASSOCIATES HEW (9)		3108.3	32	NA	NA	35.7	584	16	1.8	10.8	NA	0.00	NA	1.98*	1.20	19.0	N

EARNINGS PER SHARE

COMPANY STOCK SYMBOL (FY)	MARKET VALUE	RECENT SHARE PRICE	2002 PRICE CHANGE %	EARNINGS GROWTH 1997-2001 %	RETURN ON EQUITY	PRICE AS % OF BOOK VALUE	P-E RATIO	PRICE-SALES RATIO	PRICE-CASH FLOW RATIO	P-E TO GROWTH RATE	YIELD %	2001 ACTUAL	ESTIMATES FROM ANALYSTS			
													2002 ANALYST EST.	CON-SENSUS	LONG-TERM GROWTH RATE %	S&P EQUITY RANKING
IN INDUSTRIES HNI	1648.9	28	1	-3.5	13.5	258	19	1.0	10.4	1.3	1.79	1.26	1.46	1.64	15.0	A-
ON MOUNTAIN IRM	2807.1	33	13	NM	3.7	301	86	2.2	18.0	1.8	0.00	-0.39	0.75	0.87	25.0	NR
LLY SERVICES KELYA	880.2	25	13	-31.8	2.0	144	75	0.2	15.4	3.8	1.61	0.46	0.50	0.95	13.0	A
ANPOWER MAN	2859.5	37	11	-5.0	10.7	309	29	0.3	17.2	1.8	0.54	1.62	1.40	1.95	15.0	8
LLER (HERMAN) MLHR (5)	1515.4	20	-16	NM	-16.2	565	NM	1.1	23.7	2.7	0.73	-0.74	0.59	0.99	12.5	A-
YCHEX PAYX (5)	10982.2	29	-16	27.1	28.8	1130	39	5.2	NA	2.0	1.51	0.73	0.78	0.92	19.0	A+
NEY BOWES P8I	8349.8	35	-6	10.3	56.6	911	16	1.9	10.6	1.5	3.34	2.08	2.37	2.46	10.0	A
TTSTON PZ8	1024.1	19	-15	-18.4	15.8	195	12	0.3	3.8	0.7	0.53	0.88	1.52	1.74	17.5	B
PUBLIC SERVICES RSG	3507.8	22	8	-11.9	7.7	193	26	1.5	10.3	1.3	0.00	0.73	1.41	1.57	11.4	NR
BERT HALF INTERNATIONAL RHI	3346.0	20	-26	7.3	2.9	447	164	1.7	35.1	21.8	0.00	0.67	0.05	0.34	20.0	B+
BRE HOLDINGS TSG	3098.6	22	-49	NM	8.7	187	22	1.5	9.8	1.0	0.00	-0.35	1.87	2.07	12.3	NR
RVICEMASTER SVM	3657.8	12	-12	NM	-10.3	297	NM	1.0	NM	2.0	3.46	-0.54	0.56	0.62	11.0	A+
HERION SFN	406.8	7	-29	13.9	-0.7	60	NM	0.2	12.4	NM	0.00	1.73	-0.03	0.22	13.5	B+
EELCASE SCS (2)	1580.7	11	-27	-70.9	-3.8	117	NM	0.6	14.2	NM	2.24	0.01	-0.18	0.15	10.0	NR
ITED STATIONERS USTR	1055.9	33	-3	59.9	13.9	188	14	0.3	11.6	1.0	0.00	1.68	2.26	2.97	15.0	8
AD VVI	2011.1	23	-4	-1.3	17.1	280	16	1.2	11.1	1.2	1.58	0.58	1.39	1.57	14.0	B
ASTE MANAGEMENT WMI	15167.8	25	-22	NM	13.7	280	21	1.4	7.6	1.3	0.04	0.80	1.32	1.47	14.5	8-

TRANSPORTATION

INDUSTRY GROUP AVERAGE	5239.7	25	-12	4.3	3.7	216	42	0.6	18.8	2.1	0.73	-2.12	-1.51	0.07	11.9	
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AIR FREIGHT & LOGISTICS

INDUSTRY AVERAGE	9841.1	30	7	20.2	8.7	328	58	0.8	21.5	2.3	0.80	-0.24	1.25	1.61	14.4	
BORNE A8F	693.9	14	-3	NM	0.6	84	130	0.2	3.5	6.5	1.12	-0.40	0.18	0.61	12.0	8+
F CNF	1545.8	31	-6	NM	-19.0	198	NM	0.3	91.8	2.0	1.27	-9.06	1.29	2.28	12.0	8-
EAGL	733.3	16	12	NM	0.9	202	223	0.5	21.1	3.3	0.00	-0.84	0.24	0.68	20.0	NR
EDITORS INTL. OF WASHINGTON EXPD	3482.3	33	17	24.0	21.0	707	35	1.7	27.5	1.7	0.36	0.89	0.99	1.16	20.0	A
EX FDX (5)	15676.1	53	1	9.3	11.4	235	21	0.7	7.4	1.5	0.38	2.39	2.74	3.11	13.0	8
NT (J.B.) TRANSPORT SERVICES J8HT	1079.7	28	19	31.6	9.6	188	19	0.5	5.4	1.6	0.00	0.91	1.35	1.77	12.5	8-
ER INTERNATIONAL PACR	473.0	13	NA	NA	12.2	274	19	0.3	14.1	1.1	0.00	0.27	0.74	0.86	16.0	NR
INSON (C.H.) WORLDWIDE CHRW	2582.5	31	6	63.5	22.7	632	29	0.8	23.9	1.8	1.05	0.98	1.13	1.26	15.0	8+
ER SYSTEM R	1434.3	23	4	-34.3	6.2	110	18	0.3	2.3	1.4	2.61	0.31	1.77	1.96	9.0	B
ED PARCEL SERVICE UPS	70709.8	63	16	27.3	21.9	645	30	2.3	18.3	2.1	1.20	2.12	2.12	2.38	14.0	NR

AIRLINES

INDUSTRY AVERAGE	2000.8	10	-49	11.7	-24.7	84	51	0.3	62.3	5.3	0.09	-8.94	-9.07	-4.87	9.4	
SKA AIR GROUP ALK	561.6	21	-27	NM	-7.7	67	NM	0.3	NA	NM	0.00	-1.49	-2.25	0.72	10.0	C
ERICA WEST HOLDINGS AWA	73.9	2	-37	NM	NM	46	NM	0.0	NM	NM	0.00	-4.39	-4.21	-1.55	10.0	NR
R AMR	1208.9	8	-65	NM	NM	48	NM	0.1	NM	NM	0.00	-11.43	-13.34	-9.03	9.0	C
HOLDINGS ATAH	77.6	7	-56	NM	NM	NM	NM	0.1	NM	NM	0.00	-7.14	-6.56	-3.68	NA	C
NTINENTAL AIRLINES CAL	609.1	9	-64	NM	-43.6	54	NM	0.1	NM	NM	0.00	-1.72	-4.93	-1.92	9.0	8-
TA AIR LINES DAL	1665.2	14	-54	NM	-53.6	59	NM	0.1	NM	NM	0.74	-9.99	-8.46	-4.21	7.0	B
THWEST AIRLINES NWAC	722.3	8	-46	NM	NM	NM	NM	0.1	103.2	NM	0.00	-5.03	-5.70	-2.52	8.5	NR
THWEST AIRLINES LUV	12926.4	17	-10	11.7	6.1	299	51	2.4	21.3	5.3	0.11	0.63	0.23	0.46	14.0	A+
UAL	162.1	2	-82	NM	NM	12	NM	0.0	NM	NM	0.00	-39.90	-36.40	-22.08	7.5	C

ROAD & RAIL

INDUSTRY AVERAGE	3834.3	31	2	-5.1	9.1	199	29	0.7	7.4	1.7	1.15	1.42	1.85	2.49	11.6	
ANSAS BEST ABFS	724.4	29	1	18.4	10.4	212	20	0.5	NA	2.8	0.00	1.66	1.41	2.64	7.5	8-
LINGTON NORTHERN SANTA FE BNI	9588.0	25	-11	-0.1	9.1	119	13	1.1	5.8	1.4	1.89	1.89	2.00	2.24	9.0	NR
CSX	5890.3	28	-21	-21.9	6.2	92	15	0.7	5.8	1.1	1.45	1.38	2.09	2.55	12.0	8
X GMT	1181.6	24	-26	-48.6	5.4	138	25	0.9	2.8	1.2	5.30	0.15	1.51	1.73	13.0	A-
OSTAR SYSTEM LSTR	846.0	52	44	26.1	30.3	553	19	0.6	14.6	1.2	0.00	2.51	2.90	3.24	15.0	B
FOLK SOUTHERN NSC	7668.0	20	8	-15.6	6.9	119	17	1.2	8.0	2.1	1.42	0.94	1.17	1.43	8.0	B+
DWAY ROAD	774.0	40	9	-2.3	6.8	215	31	0.3	6.8	1.8	0.50	1.64	2.01	4.03	11.0	NR
FT TRANSPORTATION SWFT	1588.6	19	-13	NA	7.5	211	29	0.8	7.7	1.5	0.00	0.32	0.77	1.11	15.9	B+
ON PACIFIC UNP	14652.6	58	2	22.0	11.8	140	12	1.2	6.0	1.1	1.59	3.77	4.61	4.78	11.0	8
REIGHTWAYS USFC	819.6	30	-3	-9.8	2.0	132	66	0.3	NA	1.5	1.23	1.43	1.51	2.33	13.0	A-
NER ENTERPRISES WERN	1405.4	22	21	0.0	9.2	223	25	1.1	8.0	1.7	0.36	0.74	0.93	1.19	14.0	A
LOW YELL	873.2	30	18	-23.8	3.0	237	74	0.3	8.6	2.6	0.00	0.62	1.22	2.67	9.5	B-

FORMATION TECHNOLOGY

INDUSTRY AVERAGE	15056.3	19	-26	1.1	-0.1	331	64	2.5	23.5	3.8	0.25	-0.29	0.20	0.67	16.8	
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SOFTWARE & SERVICES

INDUSTRY GROUP AVERAGE	19367.3	21	-19	5.9	6.7	469	55	3.1	24.7	2.2	0.15	0.05	0.75	0.96	17.1	
INTERNET SOFTWARE & SERVICES																
INDUSTRY AVERAGE	5876.5	12	-23	NM	-13.2	316	228	6.7	40.1	5.2	0.00	-1.45	-0.03	0.19	27.5	
THLINK ELNK	957.3	6	-49	NM	-28.9	131	NM	0.7	16.0	NM	0.00	-2.73	-0.21	0.14	32.5	NR
DO! YHOO	10795.7	18	3	NM	2.4	501	228	12.6	64.1	5.2	0.00	-0.16	0.16	0.25	22.5	NR

													ESTIMATES FROM ANALYSTS					LONG-TERM	S&P
COMPANY	STOCK SYMBOL (FY)	MARKET VALUE	RECENT SHARE PRICE	2002 PRICE CHANGE %	EARNINGS GROWTH 1997-2001 %	RETURN ON EQUITY	PRICE AS % OF BOOK VALUE	P-E RATIO	PRICE-SALES RATIO	PRICE-CASH FLOW RATIO	P-E TO GROWTH RATE	YIELD %	2001 ACTUAL	2002 ANALYST EST.	CONSENSUS	GROWTH RATE %	RANK		
(B) IT CONSULTING & SERVICES																			
INDUSTRY AVERAGE		4496.2	18	-13	-5.3	10.7	496	28	0.9	19.0	1.5	0.27	0.44	0.93	1.12	14.9			
ACCENTURE	ACN (8)	17931.4	19	-28	NA	55.8	4088	34	1.5	33.8	2.3	0.00	NA	0.56*	1.01	15.0	NF		
AFFILIATED COMPUTER SERVICES	ACS (6)	6607.9	50	-6	35.8	11.8	305	27	2.0	17.5	1.4	0.00	1.23	1.76*	2.18	20.0	B+		
AMERICAN MANAGEMENT SYSTEMS	AMSY	581.2	14	-24	-15.6	5.9	143	24	0.6	18.1	0.7	0.00	0.38	0.99	0.87	19.0	B		
BEARINGPOINT	BE (6)	1573.1	8	-50	NA	4.6	158	29	0.6	15.5	1.4	0.00	-1.19	0.34*	0.51	17.0	NF		
BELL MICROPRODUCTS	BELM	145.6	7	-41	NM	-5.6	103	NM	0.1	52.8	NM	0.00	-1.34	-0.14	0.32	12.5	B-		
COMPUCOM SYSTEMS	CMPC	319.7	7	189	-36.8	5.4	136	24	0.2	9.3	1.9	0.00	0.12	0.35	0.40	10.0	B		
COMPUTER SCIENCES	CSC (3)	5989.1	35	-29	4.3	10.2	153	15	0.5	4.8	1.0	0.00	2.01	2.56	2.88	14.0	B-		
ELECTRONIC DATA SYSTEMS	EDS	8736.1	18	-73	18.6	16.6	125	8	0.4	3.9*	0.7	3.27	2.86	2.06	2.11	12.3	A		
MPS GROUP	MPS	615.1	6	-16	-38.3	1.1	77	75	0.5	15.8	2.9	0.00	0.08	0.15	0.36	13.5	NF		
PEROT SYSTEMS	PER	1204.2	11	-45	NM	10.0	186	20	0.9	12.5	1.1	0.00	-0.03	0.67	0.70	15.0	NF		
SUNGAR DATA SYSTEMS	SDS	6617.4	23	-19	NA	14.1	317	23	2.7	13.8	1.0	0.00	0.86	1.13	1.29	20.0	B-		
UNISYS	UIS	3634.1	11	-11	NM	-1.6	164	NM	0.6	30.3	1.5	0.00	-0.16	0.69	0.82	11.0	B-		
(C) SOFTWARE																			
INDUSTRY AVERAGE		36486.8	27	-25	17.2	6.1	468	68	4.7	28.4	2.7	0.06	-0.05	0.70	0.93	17.4			
AOOBE SYSTEMS	ADBE (11)	6977.1	30	-5	7.3	24.4	918	39	6.1	28.3	2.1	0.17	0.83	0.93	1.00	15.0	B		
BMC SOFTWARE	BMC (3)	4214.6	18	9	NM	-5.7	299	NM	3.4	41.8	3.3	0.00	-0.75	0.36	0.50	15.0	B-		
CAOENCE DESIGN SYSTEMS	CDN	3877.2	14	-34	-8.7	1.5	258	180	2.8	23.3	1.2	0.00	0.55	0.76	0.88	16.0	B		
COMPUTER ASSOCIATES INTL.	CA (3)	8661.9	15	-56	NM	-12.9	191	NM	2.8	NM	6.5	0.53	-1.91	0.15	0.31	15.0	B		
COMPUWARE	CPWR (3)	2063.4	5	-54	NM	-19.9	164	NM	1.3	NM	1.3	0.00	-0.66	0.33	0.33	13.0	NF		
ELECTRONIC ARTS	ERTS (3)	9844.1	68	13	NA	17.0	707	43	4.7	28.0	1.2	0.00	0.68	2.32	2.89	25.0	B		
INTUIT	INTU (7)	11070.5	54	26	NM	5.8	574	108	7.8	39.0	6.7	0.00	-0.57	0.32*	1.36	25.0	B		
MICROSOFT	MSFT (6)	308357.3	58	-13	12.0	17.3	576	34	10.3	29.7	2.7	0.00	1.38	1.41*	1.98	15.0	B		
ORACLE	ORCL (5)	65075.4	12	-12	9.3	35.9	1135	33	6.9	26.9	2.1	0.00	0.39	0.39	0.44	15.0	B		
PEOPLESFT	PSFT	6147.1	20	-51	11.1	9.9	331	34	3.1	21.6	2.3	0.00	0.59	0.56	0.61	15.0	B		
SIEBEL SYSTEMS	SEBL	4069.6	9	-70	72.0a	3.4	205	71	2.4	18.7	1.7	0.00	0.49	0.26	0.23	20.0	NF		
VERITAS SOFTWARE	VRTS	7482.9	18	-59	NM	-3.3	256	NM	5.1	26.7	1.6	0.00	-1.63	0.58	0.60	20.0	C		
20 TECHNOLOGY HARDWARE & EQUIPMENT																			
INDUSTRY GROUP AVERAGE		13331.8	18	-29	-1.3	-3.2	274	70	2.3	22.8	4.8	0.29	-0.43	-0.02	0.56	16.7			
(A) COMMUNICATIONS EQUIPMENT																			
INDUSTRY AVERAGE		14958.5	12	-41	3.7	-8.2	215	45	2.6	26.1	4.0	0.22	-1.62	-0.47	0.19	15.2			
AOC TELECOMMUNICATIONS	ADCT (10)	1735.1	2	-53	NM	NM	239	NM	1.7	NM	NM	0.00	-1.64	-1.44*	-0.10	15.0	B		
AVAYA	AV (9)	1056.2	3	-76	NM	NM	NM	NM	0.2	NM	NM	0.00	-1.33	-2.41*	-0.14	10.0	NF		
CIENA	CIEN (10)	2869.5	7	-54	NM	NM	126	NM	4.3	NM	NM	0.00	-5.75	-0.69	-0.54	20.0	NF		
CISCO SYSTEMS	CSCO (7)	107916.4	15	-18	5.5	9.7	378	40	5.6	23.0	3.0	0.00	-0.14	0.25*	0.55	20.0	B		
COMVERSE TECHNOLOGY	CMVT (1)	2266.2	12	-46	-28.2a	-9.7	144	NM	2.7	NA	NM	0.00	0.29	-0.36	-0.20	18.8	B		
CORNING	GLW	5085.6	4	-50	NM	-25.5	99	NM	1.4	NM	NM	0.00	-5.89	-0.32	-0.13	15.0	C		
HARRIS	HRS (6)	1787.8	27	-12	10.4	7.4	155	21	1.0	12.7	1.1	1.19	0.32	1.25*	1.32	19.0	B		
LUCENT TECHNOLOGIES	LU (9)	6177.8	2	-72	NM	NM	NM	NM	0.5	NM	NM	0.00	-4.18	-3.51*	-0.54	10.0	NF		
MOTOROLA	MOT	25862.9	11	-25	NM	-34.4	229	NM	1.0	NM	9.1	1.42	-1.78	0.10	0.38	12.0	A		
QUALCOMM	QCOM (9)	32091.8	41	-18	23.8	6.7	595	94	10.6	42.6	4.7	0.00	-0.74	0.44*	1.19	20.0	B		
SCIENTIFIC-ATLANTA	SFA (6)	2080.6	14	-44	7.1	5.5	147	27	1.3	NA	2.0	0.30	1.99	0.66*	0.63	10.0	B		
TELLABS	TLAB	3683.3	9	-41	NM	-13.2	158	NM	2.5	NM	NM	0.00	-0.44	-0.05	-0.04	15.0	B		
3COM	COMS (5)	1847.4	5	-19	NM	-20.6	96	NM	1.3	NM	NM	0.00	-1.71	-0.09	0.12	12.5	C		
(B) COMPUTERS & PERIPHERALS																			
INDUSTRY AVERAGE		25717.2	26	-9	18.6	6.3	454	38	1.2	21.2	2.8	0.18	0.20	0.76	1.10	13.5			
APPLE COMPUTER	AAPL (9)	5563.9	16	-29	-37.4	1.6	136	86	1.0	NA	8.6	0.00	-0.11	0.18*	0.24	10.0	B		
OELL COMPUTER	DELL (1)	73959.6	29	5	7.5	42.5	1591	39	2.2	35.9	2.4	0.00	0.46	0.80	0.98	15.0	B		
EMC	EMC	16124.4	7	-45	NM	-1.7	217	NM	3.0	29.8	NM	0.00	-0.23	-0.09	0.04	15.0	B		
GATEWAY	GTW	1234.5	4	-53	NM	-15.3	110	NM	0.3	NM	NM	0.00	-3.14	-0.66	-0.30	11.0	C		
HEWLETT-PACKARD	HPQ (10)	59433.5	19	-5	NA	-2.6	164	NM	0.8	NA	NM	1.64	-0.35	-0.31*	1.19	10.0	A		
IMATION	IMN	1451.4	41	91	NM	3.6	202	58	1.3	NA	1.5	0.00	-0.05	1.84	2.07	15.0	NF		
INTERNATIONAL BUSINESS MACHINES	IBM	146902.4	87	-28	9.5	26.1	665	26	1.8	14.6	2.2	0.69	4.35	3.91	4.31	10.0	B		
LEXMARK INTERNATIONAL	LXX	8313.8	66	12	16.6	27.6	799	30	1.9	19.3	1.7	0.00	2.05	2.76	3.11	14.0	B		
MAXTOR	MXO	1313.2	5	-15	NM	-73.0	225	NM	0.3	NA	NM	0.00	-3.12	-0.88	0.04	22.5	NF		
NCR	NCR	2688.2	28	-25	139.2	8.0	152	19	0.5	5.5	2.0	0.00	2.22	1.40	1.14	10.0	NF		
STORAGE TECHNOLOGY	STK	2340.9	22	7	-23.8	8.2	216	26	1.2	13.1	1.8	0.00	0.64	0.82	1.03	15.0	C		
SUN MICROSYSTEMS	SUNW (6)	13365.0	4	-65	NM	-5.6	144	NM	1.1	38.6	NM	0.00	0.29	-0.18*	-0.03	15.0	B		
WESTERN DIGITAL	WDC (6)	1632.7	8	35	NM	62.2	1277	21	0.7	13.0	2.3	0.00	-0.44	0.28*	0.44	13.0	C		
(C) ELECTRONIC EQUIPMENT & INSTRUMENTS																			
INDUSTRY AVERAGE		2682.1	18	-28	-18.2	-7.0	156	90	0.9	20.2	5.9	0.56	0.04	-0.13	0.78	16.8			
AGILENT TECHNOLOGIES	A (10)	9064.5	19	-32	NM	-22.1	196	NM	1.5	NM	NM	0.00	-0.89	-2.20*	0.02	15.0			
ANIXTER INTERNATIONAL	AXE	915.3	24	-16	3.9	6.3	148	24	0.4	14.1	1.6	0.00	0.89	1.05	1.33	15.0	E		
ARROW ELECTRONICS	ARW	1620.0	16	-46	NM	0.8	133	147	0.2	17.7	11.2	0.00	-0.75	0.12	0.46	12.5	E		
AVNET	AVT (6)	1690.0	14	-44	NM	-3.7	94	NM	0.2	41.7	NM	2.12	0.00	-0.71*	0.20	15.0	E		
AVX	AVX (3)	2239.7	13	-46	NM	-0.4	149	NM	1.9	17.9	42.8	1.17	-0.04	0.02	0.21	15.0	E		
BENCHMARK ELECTRONICS	BHE	754.8	31	64	NM	4.7	156	33	0.5	13.0	1.1	0.00	-2.77	1.37	1.55	20.0	E		
DIEBOLO	DBD	2855.9	40	-2	-14.8	14.1	315	22	1.5	15.3	1.6	1.67	0.93	2.21	2.42	11.0	A		

EARNINGS PER SHARE

COMPANY STOCK SYMBOL (FY)	MARKET VALUE	RECENT SHARE PRICE	2002 PRICE CHANGE %	EARNINGS GROWTH 1997-2001 %	RETURN ON EQUITY	PRICE AS % OF BOOK VALUE	P-E RATIO	PRICE-SALES RATIO	PRICE-CASH FLOW RATIO	P-E TO GROWTH RATE	YIELD %	ESTIMATES FROM ANALYSTS				
												2001 ACTUAL	2002 ANALYST EST.	CONSENSUS	LONG-TERM GROWTH RATE %	S&P EQUITY RANKING
COMPANY																
GRAM MICRO IM	2105.7	14	-19	-54.7	1.3	129	100	0.1	17.1	1.9	0.00	0.06	0.48	0.86	15.0	B+
BIL CIRCUIT JBL (8)	4246.0	21	-6	-15.9	2.3	282	126	1.2	19.0	5.0	0.00	0.59	0.17*	0.72	25.0	8
JLEX MOLX (6)	5392.2	28	-9	-19.5	4.5	297	68	3.1	17.6	4.8	0.36	1.03	0.39*	0.68	15.0	A-
RKINELMER PKI	1072.6	9	-76	NM	-5.0	88	NM	0.7	NA	1.7	3.27	-0.01	0.33	0.58	15.0	8+
JNEER-STANDARD ELECTRONICS PIOS (3)	306.6	10	-24	NM	-0.8	101	NM	0.1	30.5	3.9	1.25	-0.26	0.16	0.37	15.0	8+
NMINA-SCI SANM (9)	2429.5	5	-76	NM	-79.0	71	NM	0.3	NM	NM	0.00	0.12	-5.60*	0.11	25.0	C
LECTRON SLR (8)	4008.5	5	-57	NM	-65.2	84	NM	0.3	NM	NM	0.00	-0.19	-3.98*	0.04	22.5	C
MBOL TECHNOLOGIES SBL	2372.5	10	-35	NM	0.5	203	343	1.8	40.3	2.5	0.19	-0.24	0.21	0.40	20.0	8-
CH DATA TECD (1)	1731.4	31	-29	0.5	9.1	112	13	0.1	9.0	0.9	0.00	1.98	2.33	2.50	15.0	B+
ERMO ELECTRON TMO	3215.4	20	-18	-26.6	7.4	164	24	1.5	15.2	1.2	0.00	0.27	0.98	1.11	17.0	C
SHAY INTERTECHNOLOGY VSH	2257.0	14	-28	NM	-0.9	92	NM	1.3	14.3	3.0	0.00	0.00	0.32	0.56	15.0	8
OFFICE ELECTRONICS																
DUSTRY AVERAGE	3757.2	8	-26	NM	10.7	195	16	0.3	4.2	12.5	1.05	-0.04	0.51	0.75	11.3	
IN OFFICE SOLUTIONS IKN (9)	1102.6	8	-35	NM	9.8	72	8	0.2	NA	0.7	2.10	0.10	0.99*	0.96	10.5	8-
ROX RXR	6411.8	9	-16	NM	11.6	319	24	0.4	4.2	24.2	0.00	-0.17	0.03	0.53	12.0	8
SEMICONDUCTOR EQUIPMENT & PRODUCTS																
DUSTRY AVERAGE	14841.8	19	-36	-5.7	-5.5	305	98	4.4	28.0	3.5	0.08	-0.53	-0.19	0.20	20.3	
VANCED MICRO DEVICES AMD	3034.5	9	-43	NM	-14.3	94	NM	1.0	12.5	NM	0.00	-0.18	-1.81	-0.89	15.0	B-
ERE SYSTEMS AGR.A (9)	2261.5	1	-76	NM	NM	309	NM	1.0	NA	NM	0.00	-3.46	-1.11*	-0.18	20.0	NR
KOR TECHNOLOGY AMKR	1194.2	7	-55	NM	NM	281	NM	0.8	NM	NM	0.00	-2.87	-1.65	-0.31	25.0	NR
ALOG DEVICES ADI (10)	11247.6	31	-31	-5.9	3.6	388	110	6.6	34.6	4.4	0.00	0.93	0.28*	0.78	25.0	B
PLIED MATERIALS AMAT (10)	28098.4	17	-15	-4.8	3.4	350	107	5.6	NA	5.3	0.00	0.46	0.16*	0.20	20.0	8
MEL ATML	1634.3	4	-52	NM	-69.8	174	NM	1.4	NM	NM	0.00	-0.90	-0.36	-0.03	22.5	C
RCHILD SEMICONDUCTOR INTL. FCS	1790.6	15	-46	NA	-1.8	148	NM	1.3	12.1	4.4	0.00	-0.42	0.22	0.50	16.0	NR
EL INTC	138330.0	21	-34	-34.9	7.3	392	55	5.2	19.5	2.4	0.38	0.19	0.48	0.60	18.0	A
-TENCOR KLAC (6)	8334.4	44	-11	9.8	8.9	408	49	5.5	33.3	2.0	0.00	1.93	1.10*	0.64	20.0	B
EAR TECHNOLOGY LLTC (6)	10360.3	33	-15	1.2	12.1	609	52	19.4	40.9	2.2	0.60	1.29	0.60*	0.71	25.0	A
LOGIC LSI	3175.5	9	-46	NM	-22.3	138	NM	1.8	NM	NM	0.00	-2.84	-0.12	0.25	20.0	C
NIM INTEGRATED PRODUCTS MXIM (6)	13414.0	42	-20	0.3	15.2	751	53	12.5	NA	2.3	0.19	0.93	0.73*	0.93	25.0	8+
IRON TECHNOLOGY MU (8)	9531.8	16	-49	NM	-14.3	151	NM	3.7	35.6	NM	0.00	-0.88	-1.51*	-0.49	18.0	C
IONAL SEMICONDUCTOR NSM (5)	3673.1	20	-34	NM	NA	208	NM	2.3	22.5	NM	0.00	-0.69	0.01	0.45	17.0	8-
ELLUS SYSTEMS NVLS	5189.5	36	-8	NM	2.0	276	140	6.3	62.1	5.9	0.00	0.97	0.27	0.42	22.5	8
DIA NVDA (1)	2700.6	17	-74	NM	12.8	307	29	1.4	15.8	1.2	0.00	1.03	0.72	0.61	20.0	NR
SEMICONDUCTOR ONNN	385.0	2	6	NA	NM	NM	NM	0.4	NM	NM	0.00	-4.21	-0.70	-0.43	17.0	NR
ADYNE TER	3000.7	16	-46	NM	-26.8	198	NM	2.7	NA	NM	0.00	-1.15	-1.18	-0.30	20.0	8
AS INSTRUMENTS TXN	34637.4	20	-29	NM	1.2	312	286	4.3	19.7	5.2	0.42	-0.12	0.19	0.32	20.0	8+
MATERIALS																
CTOR AVERAGE	4034.8	27	-4	1.5	6.3	234	42	0.8	9.7	2.5	1.81	0.24	1.16	1.70	10.8	
MATERIALS																
DUSTRY GROUP AVERAGE	4034.8	27	-4	1.5	6.3	234	42	0.8	9.7	2.5	1.81	0.24	1.16	1.70	10.8	
CHEMICALS																
DUSTRY AVERAGE	4752.6	27	-9	6.2	7.0	279	46	1.0	10.9	2.6	2.13	0.26	1.41	1.82	9.7	
PRODUCTS & CHEMICALS APD (9)	9653.4	44	-6	-1.2	15.2	279	19	1.8	8.7	2.0	1.90	2.12	2.36*	2.54	9.5	A-
GAS ARG (3)	1202.1	17	11	4.7	9.8	218	22	0.7	9.5	1.6	0.00	0.69	0.93	1.12	11.0	8
OT C8T (9)	1556.4	25	-29	10.0b	10.4	173	17	1.0	7.1	1.3	2.05	1.62	1.48*	1.97	13.0	B
MPTON CK	803.1	7	-22	NM	-27.1	301	NM	0.3	9.5	1.5	2.83	-1.10	0.50	0.66	9.5	8
EC INDUSTRIES CYT	1048.4	27	-1	-9.9	9.6	151	16	0.8	6.9	1.4	0.00	1.59	1.92	1.92	10.0	B
V CHEMICAL DOW	29064.3	32	-6	NM	3.8	297	80	1.1	13.8	5.9	4.20	-0.46	0.61	1.44	9.0	8+
ONT DD	44325.8	45	5	34.9	46.6	391	8	1.9	6.4	2.5	3.14	4.15	1.99	2.30	9.0	A-
TMAN CHEMICAL EMN	3019.6	39	0	NM	0.0	208	NM	0.6	7.4	3.2	4.50	-2.33	1.62	2.76	7.5	8-
LAB ECL	6429.5	50	23	9.5	18.9	611	32	2.1	17.4	2.1	1.09	1.45	1.84	2.02	13.0	A
ELHARD EC	3100.4	24	-12	51.3	16.4	288	18	0.8	10.9	1.4	1.65	1.71	1.77	1.93	10.0	A-
IO FOE	961.5	24	-8	NM	6.0	418	29	0.6	NA	2.0	2.44	1.04	1.20	1.63	10.0	8+
FMC	994.3	28	-52	NM	4.9	236	53	0.5	NA	1.4	0.00	-9.85	2.50	2.77	8.0	C
ER (H.B.) FUL (11)	821.6	29	1	2.5	6.8	181	27	0.7	9.2	1.9	1.52	1.59	1.62	1.81	9.5	8+
RGIA GULF GGC	673.6	21	13	NM	14.3	584	41	0.6	7.8	2.8	1.53	-0.38	0.95	2.50	8.0	8-
AT LAKES CHEMICAL GLK	1262.5	25	3	NM	-1.1	167	NM	0.9	17.5	3.3	1.27	-5.76	0.95	1.35	8.0	8+
CULES HPC	1028.7	9	-6	NM	-31.1	541	NM	0.5	23.4	1.8	0.00	-0.54	0.69	0.83	7.5	B
GLOBAL IGL	1500.5	13	0	NM	1.2	291	261	0.7	8.5	19.0	0.61	-0.24	0.10	0.51	7.0	8-
FLAVORS & FRAGRANCES IFF	3115.1	33	11	-11.8	28.9	541	19	1.7	12.0	1.6	1.82	1.20	1.94	2.18	11.0	B
PRIZOL LZ	1603.2	31	-11	-9.0	14.1	186	13	0.8	7.4	1.6	3.34	1.83	2.43	2.24	8.0	B+
ODELL CHEMICAL LYO	2287.4	14	0	NM	-7.4	176	NM	0.7	14.0	NM	6.29	-1.24	-0.65	0.43	8.0	8-
ENNIM CHEMICALS MCH	687.2	11	-13	NM	-3.0	127	NM	0.5	7.9	NM	4.95	-0.68	-0.59	0.66	7.5	NR
SANTO MON	4597.8	18	-48	NA	-0.7	90	NM	1.0	10.2	1.6	2.73	1.13	1.09	1.48	10.0	NR
OLN	863.1	15	-7	NM	-3.9	184	NM	0.7	12.7	NM	5.30	-0.22	-0.48	1.09	6.0	8
GROUP OMG	199.0	7	-89	16.1	-0.3	26	235	0.0	2.8	0.2	0.00	3.28	2.46	1.49	14.5	A
ONE POL	714.8	8	-20	NM	-2.7	108	NM	0.3	12.6	3.5	3.21	-0.51	0.22	0.69	10.0	8-
INDUSTRIES PPG	8485.3	50	-3	-12.8	-2.6	306	NM	1.1	25.0	2.2	3.43	2.29	2.81	3.32	8.0	A-

INVESTMENT OUTLOOK SCOREBOARD

EARNINGS PER SHARE

COMPANY	STOCK SYMBOL (FY)	MARKET VALUE	RECENT SHARE PRICE	2002 PRICE CHANGE %	EARNINGS GROWTH 1997-2001 %	RETURN ON EQUITY	PRICE AS % OF BOOK VALUE	P-E RATIO	PRICE-SALES RATIO	PRICE-CASH FLOW RATIO	P-E TO GROWTH RATE	YIELD %	ESTIMATES FROM ANALYSTS				S&P EQUITY RANKING
													2001 ACTUAL	2002 ANALYST EST.	CON-SENSUS	LONG-TERM GROWTH RATE %	
PRAXAIR PX		9541.0	59	7	0.5	23.9	433	18	1.9	9.4	1.8	1.29	2.64	3.30	3.57	10.0	A
ROHM & HAAS ROH		7824.5	35	2	NM	9.0	241	27	1.4	10.2	2.1	2.37	-0.31	1.71	2.10	10.0	A
RPM INTERNATIONAL RPM (5)		1765.8	15	6	2.2	12.3	198	16	0.9	10.7	1.5	3.38	0.97	1.05	1.17	10.0	A
SCOTTS SMG (9)		1451.3	49	3	2.0a	17.0	244	15	0.8	NA	1.0	0.00	0.51	3.19*	3.71	15.0	B
SIGMA-ALORICH SIAL		3630.6	50	28	7.2	18.8	429	23	3.0	16.0	2.2	0.72	1.87	2.28	2.53	10.0	A+
SOLUTIA SOI		282.9	3	-81	NM	NM	NM	NM	0.1	2.9	0.7	1.48	-0.57	0.44	0.76	9.0	NR
VALSPAR VAL (10)		2340.3	47	18	9.8	16.3	317	20	1.1	NA	1.5	1.20	1.10	2.34*	2.68	13.0	A
(B) CONSTRUCTION MATERIALS																	
INDUSTRY AVERAGE		2058.1	32	-25	-1.8	10.2	136	13	0.8	5.7	1.8	1.87	2.49	2.03	2.47	11.0	
LAFARGE NORTH AMERICA LAF		2343.3	32	-15	6.1	12.7	107	9	0.7	5.0	0.8	1.87	3.21	3.52	3.78	11.0	B+
MARTIN MARIETTA MATERIALS MLM		1538.2	32	-32	0.7	9.8	141	14	0.9	6.1	1.6	1.90	2.19	2.03	2.23	10.0	NR
TEXAS INDUSTRIES TXI (5)		519.7	25	-33	-15.9	6.6	68	11	0.4	3.5	3.3	1.21	2.38	0.69	1.70	11.0	B+
VULCAN PRODUCTS VMC		3831.4	38	-21	1.7	11.8	228	19	1.3	8.2	1.7	2.49	2.17	1.86	2.16	12.0	A
(C) CONTAINERS & PACKAGING																	
INDUSTRY AVERAGE		2129.0	27	22	10.4	15.5	300	22	0.7	7.4	2.1	1.03	0.71	1.62	1.93	9.4	
BALL BLL		2811.8	49	40	NM	25.0	519	21	0.7	10.0	1.8	0.73	-1.85	2.71	3.32	10.0	B-
BEMIS BMS		2738.2	52	5	8.6	16.6	282	17	1.2	9.8	1.7	2.01	2.64	3.07	3.22	10.0	A
CROWN CORK & SEAL CCK		1376.8	9	240	NM	NM	567	NM	0.2	NM	2.7	0.00	-7.77	0.53	0.84	6.0	C
GREIF BROS. GEF (10)		574.5	26	-22	NA	5.7	99	17	0.4	4.4	1.9	2.18	3.96	1.33	1.41	10.0	B+
OWENS-ILLINOIS OI		2313.4	16	57	3.5	-4.4	198	NM	0.4	6.1	0.9	0.00	2.33	2.02	2.14	9.0	B
PACKAGING CORP. OF AMERICA PKG		1873.5	18	-1	36.6	7.0	238	34	1.1	9.3	NA	0.00	0.99	0.49	1.00	NA	NR
PACTIV PTV		3276.5	21	17	13.4	24.0	379	16	1.2	8.9	1.3	0.00	1.03	1.34	1.44	12.0	NR
ROCK-TENN RKT (9)		434.5	13	-12	17.3b	8.0	107	14	0.3	4.1	1.1	2.52	0.90	0.94*	1.07	11.8	B
SEALEO AIR SEE		3173.7	38	-7	-15.4	8.1	321	18	1.0	8.2	1.2	0.00	1.22	2.46	2.45	12.5	NR
SILGAN HOLDINGS SLGN		450.3	25	-6	-2.2	75.3	639	9	0.2	3.1	1.3	0.00	2.31	2.76	2.90	7.0	NR
SMURFIT-STONE CONTAINER SSCC		3565.7	15	-9	NM	2.9	142	47	0.4	7.0	4.6	0.00	0.29	0.42	1.01	7.5	NR
SONOCO PRODUCTS SON		2453.1	25	-4	NM	14.6	280	19	0.9	8.5	1.7	3.30	0.96	1.47	1.64	10.0	B+
TEMPLE-INLAND TIN		2634.9	49	-14	21.1	3.5	127	34	0.6	9.0	4.5	2.61	2.26	1.57	2.69	7.0	B
(D) METALS & MINING																	
INDUSTRY AVERAGE		3918.5	21	-11	-23.9	-0.1	131	73	0.9	11.1	1.9	1.52	-0.51	0.38	1.26	18.0	
AK STEEL HOLDING AKS		873.9	8	-29	NM	-6.2	85	NM	0.2	5.4	NM	0.00	-0.87	-0.10	1.02	5.0	NR
ALCOA AA		21570.4	26	-28	-2.4	4.4	202	46	1.0	13.5	1.7	2.35	1.05	1.02	1.61	15.0	B+
ALLEGHENY TECHNOLOGIES ATI		576.5	7	-57	NM	-8.1	65	NM	0.3	28.1	NM	3.36	-0.31	-0.29	0.11	6.5	NR
ARCH COAL ACI		1048.2	20	-12	-37.8	0.9	189	222	0.7	5.8	NM	1.15	0.15	-0.15	1.33	12.5	NR
FREEPORT-McMORAN COPPER & GOLD FCX		2245.9	16	16	-15.9	9.8	NM	38	1.3	6.2	0.9	0.00	0.53	0.88	1.39	20.0	B-
NEWMONT MINING NEM		9403.9	23	23	NM	1.8	175	84	4.1	16.3	3.0	0.51	-0.16	0.39	0.73	20.0	B-
NUCOR NUE		3927.5	50	-5	-18.9	6.4	171	27	0.9	8.9	1.8	1.51	1.45	1.83	3.06	15.0	B+
PEABODY ENERGY BTU		1422.3	27	-3	NA	7.4	129	18	0.5	4.5	2.3	1.47	0.38	1.33	1.69	9.0	N
PHELPS DODGE PD		2793.2	31	-3	NM	-5.0	90	NM	0.7	9.7	NM	0.00	-3.47	-1.79	0.58	12.0	C
RYERSON TULL RT		170.0	7	-38	NM	-11.4	37	NM	0.1	NM	NM	2.92	-2.44	-0.48	-0.04	83.0	B-
UNITED STATES STEEL X		1479.1	14	-20	NM	-4.5	53	NM	0.2	6.3	2.3	1.38	-2.45	0.77	2.29	8.0	B-
WORTHINGTON INDUSTRIES WOR (5)		1510.6	18	24	-44.6	3.2	242	77	0.8	17.0	1.5	3.63	0.08	1.14	1.32	10.5	B
(E) PAPER & FOREST PRODUCTS																	
INDUSTRY AVERAGE		5334.0	33	-9	-2.6	-2.3	139	61	0.6	8.5	4.7	2.18	-0.60	0.12	1.07	6.6	
BOISE CASCADE BCC		1578.3	27	-20	NM	-3.2	109	NM	0.2	5.9	NM	2.22	-0.96	-0.04	0.93	7.0	B-
BOWATER BOW		2469.1	43	-9	2.3	-3.1	128	NM	0.9	8.5	NM	1.84	1.37	-2.96	-0.71	8.0	B-
GEORGIA-PACIFIC GP		5155.2	21	-25	NM	-2.7	98	NM	0.2	5.1	2.4	2.42	-2.09	1.41	2.08	6.0	B
INTERNATIONAL PAPER IP		18843.9	39	-3	NM	-1.4	185	NM	0.8	12.5	5.3	2.55	-2.37	1.06	1.85	7.0	B-
LOUISIANA-PACIFIC LPX		937.0	9	6	NM	-4.1	88	NM	0.5	9.2	NM	0.00	-1.64	-0.18	0.37	7.0	C
POTLATCH PCH		768.5	27	-8	NM	-12.7	153	NM	0.6	11.5	NM	2.23	-2.81	-1.19	-0.13	4.0	B-
RAYONIER RYN		1282.2	46	-8	-8.5	6.8	174	26	1.2	6.2	3.6	3.11	2.09	1.84	1.97	7.0	B
WEYERHAEUSER WY		11637.9	53	-3	-1.6	1.9	176	96	0.7	9.5	7.3	3.04	1.61	1.03	2.21	7.0	B-
TELECOMMUNICATION SERVICES																	
SECTOR AVERAGE		23389.9	23	-29	0.1	-17.2	374	134	1.3	11.1	6.6	1.30	-1.39	0.95	1.05	10.7	
22 TELECOMMUNICATION SERVICES																	
INDUSTRY GROUP AVERAGE		23389.9	23	-29	0.1	-17.2	374	134	1.3	11.1	6.6	1.30	-1.39	0.95	1.05	10.7	
(A) DIVERSIFIED TELECOMMUNICATION SERVICES																	
INDUSTRY AVERAGE		30184.1	23	-26	-2.4	-5.7	198	134	1.3	6.2	2.3	1.79	-1.45	1.03	1.08	8.6	
ALLTEL AT		17131.6	55	-11	12.2	15.4	293	19	2.2	8.4	2.1	2.54	3.34	3.22	3.41	8.0	A
AT&T T		21596.9	28	-69	NM	-32.9	50	NM	0.4	NM	2.5	2.67	-6.65	1.13	0.98	10.0	N
BELLSOUTH BLS		51763.6	28	-27	-4.5	16.7	297	18	2.2	6.8	2.9	2.88	1.36	2.09	1.97	4.6	A
BROADWING BRW		882.6	4	-57	NM	NM	NM	NM	0.4	3.2	NM	0.00	-1.36	-0.42	-0.48	9.6	C
CENTURYTEL CTL		4386.3	31	-6	6.5	6.4	144	22	2.3	7.2	1.2	0.68	2.41	2.21	2.24	12.0	A
CITIZENS COMMUNICATIONS CZN		2782.7	10	-8	NM	-69.7	215	NM	1.0	NM	NM	0.00	-0.28	-0.31	0.21	15.0	N
LEVEL 3 COMMUNICATIONS LVL3		2542.9	6	22	NM	NY	NM	NM	1.0	NM	NM	0.00	-14.58	-2.68	-2.45	9.4	N
QWEST COMMUNICATIONS INTL. Q		8107.0	5	-66	NM	-7.8	23	NM	0.5	3.8	NM	0.00	-2.38	-0.49	-0.30	10.8	C
SBC COMMUNICATIONS SBC		94625.8	29	-27	15.6	20.3	292	15	2.2	6.2	2.5	3.79	2.14	2.25	2.00	5.0	A-

EARNINGS PER SHARE

COMPANY STOCK SYMBOL (FY)	MARKET VALUE	RECENT SHARE PRICE	2002 PRICE CHANGE %	EARNINGS GROWTH 1997-2001 %	RETURN ON EQUITY	PRICE AS % OF BOOK VALUE	P-E RATIO	PRICE-SALES RATIO	PRICE-CASH FLOW RATIO	P-E TO GROWTH RATE	YIELD %	ESTIMATES FROM ANALYSTS				
												2001 ACTUAL	2002 ANALYST EST.	CONSENSUS	LONG-TERM GROWTH RATE %	S&P EQUITY RANKING
PRINT FON GROUP FON	13632.3	15	-27	NM	-0.9	111	NM	0.9	5.5	2.1	3.43	-0.16	1.33	1.38	5.1	B
RIZON COMMUNICATIONS VZ	114573.8	42	-12	-41.7	0.8	360	598	1.7	8.3	2.5	3.68	0.22	3.05	2.95	5.4	B+
WIRELESS TELECOMMUNICATION SERVICES																
INDUSTRY AVERAGE	8442.6	22	-34	6.5	-37.8	689	NM	1.1	24.3	16.8	0.21	-1.26	0.75	0.99	15.3	
AT&T WIRELESS SERVICES AWE	17380.1	8	-47	0.0	-8.8	88	NM	1.2	58.7	47.2	0.00	0.05	0.01	0.06	20.0	NR
AXTEL COMMUNICATIONS NXTL	13227.5	14	25	NM	-97.8	2358	NM	1.6	NM	NM	0.00	-4.27	-0.13	0.65	15.0	C
PRINT PCS GROUP PCS	5849.0	6	-76	NM	-51.5	779	NM	0.5	4.9	NM	0.00	-1.27	-0.69	-0.38	19.0	NR
TELEPHONE & DATA SYSTEMS TDS	3216.4	55	-39	NM	-30.6	113	NM	1.1	NM	2.1	1.06	-2.87	2.78	2.89	9.5	B
S. CELLULAR USM	2540.0	30	-35	13.0	0.0	106	NM	1.2	9.2	1.3	0.00	2.07	1.79	1.72	13.1	8-
UTILITIES																
INDUSTRY AVERAGE	3750.6	23	-25	8.1	7.4	128	14	0.7	5.7	2.0	4.65	2.10	2.09	2.16	6.7	
ELECTRIC UTILITIES																
INDUSTRY AVERAGE	3750.6	23	-25	8.1	7.4	128	14	0.7	5.7	2.0	4.65	2.10	2.09	2.16	6.7	
EDISON ENERGY AVE	4878.0	27	-20	8.5	9.2	134	13	0.8	5.6	2.0	5.30	2.35	2.52	2.57	6.0	
EDISON ENERGY AVE	864.2	7	-81	12.9	11.3	34	3	0.1	1.4	0.6	0.00	3.73	2.16	2.01	5.0	A-
EDISON ENERGY AVE	1997.5	23	-7	11.5	10.6	163	15	1.4	NA	1.6	4.70	1.68	1.83	2.19	8.0	A-
EDISON ENERGY AVE	1491.2	16	-46	4.9	6.4	84	12	0.6	3.2	2.8	12.29	2.30	1.29	1.73	4.5	8+
EDISON ENERGY AVE	6347.2	41	-2	5.2	10.9	157	13	1.5	7.1	2.6	6.14	3.45	3.12	3.16	5.0	A-
EDISON ENERGY AVE	9629.7	28	-35	1.0	8.6	111	12	0.4	4.4	2.5	8.44	3.11	2.90	2.82	4.0	8+
EDISON ENERGY AVE	694.9	26	-24	23.4	9.6	131	14	1.2	5.8	1.1	4.49	3.42	2.28	2.47	10.0	A
EDISON ENERGY AVE	2290.6	8	-71	17.6	23.1	120	5	0.2	2.1	1.0	8.37	3.14	1.32	1.04	6.0	B
EDISON ENERGY AVE	5451.9	32	-3	4.9	11.5	167	14	0.7	6.9	2.5	5.56	2.75	2.55	2.65	5.0	8+
EDISON ENERGY AVE	1433.7	10	-59	NA	-14.8	71	NM	0.2	4.5	1.3	7.24	-2.53	1.52	1.47	5.0	8
EDISON ENERGY AVE	8486.0	40	-2	2.2	11.0	144	13	1.0	7.2	3.2	5.58	3.21	3.14	3.17	4.0	A-
EDISON ENERGY AVE	4334.6	26	-1	-25.8	4.8	109	21	1.0	6.3	1.5	3.64	0.52	2.47	2.64	7.0	8+
EDISON ENERGY AVE	14215.1	51	-15	-0.6	9.9	157	16	1.4	6.5	1.5	5.06	2.15	4.85	4.74	7.3	8
EDISON ENERGY AVE	1911.4	15	-37	8.3	9.2	240	24	1.6	9.0	1.6	6.22	1.56	1.58	1.54	6.0	A
EDISON ENERGY AVE	1107.9	15	-22	NM	-3.0	215	NM	1.0	4.8	2.6	6.80	-2.75	1.25	1.23	4.5	8
EDISON ENERGY AVE	7423.5	44	6	-7.0	13.0	149	11	1.0	5.2	1.6	4.65	2.14	3.85	4.01	7.0	B+
EDISON ENERGY AVE	3613.2	11	-27	43.3	69.7	82	1	0.3	0.8	0.8	0.00	7.36	1.79	1.57	8.0	8
EDISON ENERGY AVE	9719.6	44	12	32.6	6.4	124	19	1.2	6.9	1.4	3.20	3.13	3.65	3.86	8.5	8
EDISON ENERGY AVE	16210.6	50	5	32.4	18.9	190	10	1.1	5.5	1.8	3.51	4.39	4.70	4.89	6.0	B
EDISON ENERGY AVE	9429.1	32	-9	10.1	9.8	121	11	0.8	5.0	1.5	4.73	2.84	2.98	3.46	7.0	A-
EDISON ENERGY AVE	10731.8	59	4	6.7	10.4	170	15	1.3	6.4	2.1	3.95	4.62	4.75	4.87	6.0	A-
EDISON ENERGY AVE	1392.3	22	-11	NM	-3.4	172	NM	0.8	10.9	2.3	7.38	-0.68	1.93	1.95	5.0	B
EDISON ENERGY AVE	1573.0	43	7	1.7	10.8	152	13	1.0	NA	5.8	5.77	3.18	3.28	3.25	2.3	B+
EDISON ENERGY AVE	928.2	25	-40	9.6	9.0	104	11	0.3	5.1	3.0	7.59	3.35	1.02	1.71	8.0	A-
EDISON ENERGY AVE	1857.4	14	-18	NM	6.3	85	13	0.3	5.4	3.7	3.83	1.96	0.98	1.18	4.0	8
EDISON ENERGY AVE	2169.0	41	-9	NM	10.7	170	16	0.8	5.8	2.0	5.18	-0.05	3.37	3.48	6.0	B
EDISON ENERGY AVE	1291.2	16	-29	-5.4	10.3	119	11	0.5	4.3	2.6	8.08	1.29	1.43	1.34	4.5	A-
EDISON ENERGY AVE	3277.6	20	-11	2.1	5.6	114	16	1.0	9.1	2.1	4.99	1.50	1.82	1.94	5.3	B
EDISON ENERGY AVE	5235.9	14	-28	13.3	31.0	93	3	0.3	1.6	0.8	0.00	2.99	2.25	1.94	8.0	B
EDISON ENERGY AVE	2722.3	32	-23	8.7	10.0	102	10	1.0	4.0	1.6	5.29	3.85	3.45	3.20	6.0	A
EDISON ENERGY AVE	923.2	24	-16	16.9	5.5	89	16	0.8	5.8	2.5	3.73	3.77	1.90	1.99	5.0	B
EDISON ENERGY AVE	5466.4	33	-4	-10.4	-3.2	224	NM	1.0	10.0	1.6	4.32	1.15	3.42	3.65	6.0	B
EDISON ENERGY AVE	9321.2	42	-7	-0.1	5.0	150	29	1.1	7.8	1.6	5.19	2.64	3.85	3.83	7.0	A-
EDISON ENERGY AVE	6207.0	30	-29	11.1	9.5	169	18	0.8	6.7	1.3	7.21	3.67	3.73	3.78	6.0	B+
EDISON ENERGY AVE	1890.7	22	-2	0.6	4.5	137	28	0.8	6.3	3.0	4.64	1.31	1.19	1.79	6.0	B
EDISON ENERGY AVE	18640.8	26	3	2.8	14.0	214	15	1.8	7.9	3.0	5.24	1.61	1.77	1.83	5.0	A-
EDISON ENERGY AVE	2302.5	15	-44	8.7	13.6	95	7	0.9	3.6	1.3	9.63	2.24	2.25	1.62	5.0	NR
EDISON ENERGY AVE	4422.1	15	-67	2.2	7.9	49	5	0.2	2.4	0.7	3.24	3.12	2.96	2.27	7.3	B
EDISON ENERGY AVE	2659.3	23	2	34.7	6.2	129	21	0.7	5.9	2.1	3.48	1.77	2.23	2.31	5.0	B
EDISON ENERGY AVE	1174.7	37	1	7.0	12.3	153	11	0.5	5.8	2.4	5.80	2.74	2.53	2.76	6.0	B+
EDISON ENERGY AVE	4282.2	11	-61	9.1	-33.1	82	NM	0.4	NM	1.1	6.98	2.27	1.46	1.35	7.0	8+
GAS UTILITIES																
INDUSTRY AVERAGE	2101.2	27	-6	5.2	12.3	175	16	0.7	6.3	3.0	4.45	1.89	1.95	2.23	6.3	
EDISON ENERGY AVE	5006.5	35	2	NA	10.3	173	16	0.9	5.8	1.7	5.04	1.70	2.66	2.86	8.0	B
EDISON ENERGY AVE	846.5	31	1	7.9	15.3	228	15	0.5	9.5	2.2	3.94	2.00	2.09*	2.25	7.0	A-
EDISON ENERGY AVE	1386.9	32	-24	5.0	17.9	191	11	0.8	5.1	2.2	5.84	3.17	2.60	2.78	5.5	B+
EDISON ENERGY AVE	4049.5	19	-15	-8.5	10.2	121	12	0.6	4.3	1.9	5.95	1.01	1.89	1.67	5.5	A-
EDISON ENERGY AVE	1276.6	36	-5	2.8	11.0	158	14	0.9	6.8	2.7	5.78	2.74	2.51*	2.75	5.3	B+
EDISON ENERGY AVE	4746.0	23	-6	8.5	18.8	174	9	0.8	4.1	1.1	4.32	2.52	2.54	2.65	8.0	NR
EDISON ENERGY AVE	826.9	15	-17	6.3a	6.4	122	20	0.7	7.0	6.1	0.00	0.98	0.35*	1.02	7.0	B
EDISON ENERGY AVE	736.2	22	-1	17.4	6.6	131	20	0.5	4.5	3.2	3.69	1.15	1.40	1.60	5.0	B
EDISON ENERGY AVE	1014.5	37	22	22.4	21.7	309	14	0.5	6.2	1.8	4.48	1.90	2.70*	2.99	7.5	8+
EDISON ENERGY AVE	1122.3	23	-21	-14.8	4.9	146	29	1.2	9.9	7.2	5.50	1.75	0.80*	1.69	4.0	B+

												ESTIMATES FROM ANALYSTS					
COMPANY	STOCK SYMBOL (FY)	MARKET VALUE	RECENT SHARE PRICE	2002 PRICE CHANGE %	EARNINGS GROWTH 1997-2001 %	RETURN ON EQUITY	PRICE AS % OF BOOK VALUE	P-E RATIO	PRICE-SALES RATIO	PRICE-CASH FLOW RATIO	P-E TO GROWTH RATE	YIELD %	ESTIMATES FROM ANALYSTS			LONG-TERM GROWTH RATE %	S&P EQUITY RANK
													2001 ACTUAL	2002 ANALYST EST.	CONSENSUS		
(C) MULTI-UTILITIES & UNREGULATED POWER																	
INDUSTRY AVERAGE		2320.6	14	-44	8.9	1.1	93	15	0.6	5.3	1.4	3.43	1.71	1.29	1.33	8.3	
AES	AES	1060.0	2	-87	4.1	6.9	44	7	0.1	NA	0.2	0.00	0.87	0.89	0.85	10.0	B
AQUILA	ILA	366.2	2	-92	10.7	-42.4	16	NM	0.0	NM	2.4	0.00	2.42	0.21	0.37	4.0	N
AVISTA	AVA	468.3	10	-26	-11.4	2.2	65	29	0.3	5.1	3.7	4.91	1.20	0.67	0.86	4.0	B
CALPINE	CPN	1673.8	4	-74	82.6	5.7	43	8	0.2	2.6	0.5	0.00	1.85	0.75	0.72	13.0	N
DUKE ENERGY	DUK	16502.6	20	-50	19.6	9.1	117	12	0.8	5.9	1.2	5.57	2.56	1.92	1.87	8.5	A-
DYNEGY	DYN	430.8	1	-95	NM	-33.1	17	NM	0.0	NM	0.7	0.00	1.89	0.16	0.01	11.0	N
EL PASO	EP	5091.8	9	-81	-46.6	5.8	50	7	0.2	2.5	0.5	10.21	0.13	1.56	1.31	10.0	B
ENERGY EAST	EAS	3139.4	22	14	5.7	7.8	127	13	0.9	7.4	2.2	4.43	1.61	1.62	1.87	6.0	B-
EQUITABLE RESOURCES	EQT	2252.7	35	4	3.5	16.8	286	17	2.5	11.0	1.5	1.93	2.30	2.40	2.76	10.0	B
MDU RESOURCES GROUP	MDU	1753.2	25	-13	16.8	10.8	146	13	0.9	6.2	1.5	3.91	2.29	1.67	1.92	10.0	A
MIRANT	MIR	852.2	2	-87	NM	0.6	16	11	0.0	2.1	0.2	0.00	1.62	1.39	1.13	10.0	N
NATIONAL FUEL GAS	NFG (9)	1664.7	21	-16	48.8	11.7	165	14	1.1	5.6	2.0	5.01	0.82	1.46*	1.65	7.0	B-
NORTHWESTERN	NOR	219.0	8	-62	4.1	13.7	73	5	0.1	1.3	0.7	15.80	1.53	1.53	1.25	7.5	A
ONEOK	OKE	1145.0	19	6	1.1	6.4	85	15	0.4	3.9	1.7	3.27	1.04	1.36	1.46	8.0	A-
QUESTAR	STR	2135.4	26	4	12.9	13.3	195	15	1.8	6.6	1.7	2.84	1.94	1.74	1.95	9.0	A-
RELIANT RESOURCES	RRI	682.5	2	-86	NA	5.9	11	2	0.0	0.9	0.2	0.00	2.00	1.57	1.01	8.0	N
SCANA	SCG	3332.1	30	8	25.7	2.5	153	54	1.2	11.7	2.5	4.32	5.15	2.42	2.58	5.0	B+
SIERRA PACIFIC RESOURCES	SRP	708.8	7	-54	-32.6	-17.9	50	NM	0.2	NM	1.4	0.00	0.34	1.03	1.00	5.0	B
VECTREN	VVC	1543.8	23	-5	-2.1	12.3	178	15	0.8	6.9	1.7	4.83	1.01	1.74	1.84	7.5	B
WILLIAMS	WMB	1389.4	3	-89	NA	-15.3	27	NM	0.2	NA	NM	1.49	1.67	-0.31	0.11	12.0	B

ALPHABETICAL LIST OF COMPANIES

The number following each company name identifies the Scoreboard category under which it is listed

B	American Express 11	Avon Products 8b	Bristol-Myers Squibb 15b	CMS Energy 23a	D	Electronic Data Systems 19b
Abbott Laboratories 15b	American Financial Group 12	AVX 20c	Broadway 22a	CNA Financial 12	D&K Healthcare Resources 14b	EMC 20b
Abercrombie & Fitch 5d	American Greetings 2a		Brown-Forman 7a	CNF 18a	Daisytek Intl. 17	Emcor Group 16c
ABM Industries 17	American Intl. Group 12	B	Brunswick 2b	Cobalt 14b	Dana 1a	Emerson Electric 16d
Accenture 19b	American Mgmt. Systems 19b	Baker Hughes 9a	Bunge 7b	Coca-Cola 7a	Danaher 16f	Energizer Holdings 16d
ACE 12	American Power 16d	Ball 21c	Burlington Coat Factory 5d	Coca-Cola Enterprises 7a	Darden Restaurants 3	Energy East 23c
Acuity Brands 16d	American Standard 16b	Bank of America 10	Burlington Northern Santa Fe 18d	Colgate-Palmolive 8a	DaVita 14b	Engelhard 21a
ADC Telecomm. 20a	AmeriCredit 11	Bank of New York 10	Burlington Resources 9b	Collins & Aikman 1a	Dean Foods 7b	Entergy 23a
Adminstaff 17	AmerisourceBergen 14b	Bank One 10		Colonial BancGroup 10	Deere 16f	EOG Resources 9b
Adobe Systems 19c	AmerUs Group 12	Banknorth Group 10	C	Comerica 10	Del Monte Foods 7b	Equitable Resources 23c
Advance Auto Parts 5d	Amgen 15a	Banta 17	Cablevision Systems 4	Commerce Bancorp 10	Dell Computer 20b	Equity Office Properties 13
Advanced Micro 20e	Amkor Technology 20e	Bard (C.R.) 14a	Cabot 21a	Commerce Bancshares 10	Delphi 1a	Equity Residential 13
AdvancePCS 14b	AMR 18b	Barnes & Noble 5d	Cadence Design Systems 19c	Commerce Group 12	Delta Air Lines 18b	Estee Lauder 8b
AES 23c	AmSouth Bancorporation 10	Barr Laboratories 15b	Calpine 23c	Community Health Sys. 14b	Devon Energy 9b	Everest Re Group 12
Aetna 14b	Anadarko Petroleum 9b	Bausch & Lomb 14a	Campbell Soup 7b	Compass Bancshares 10	Dial 8a	Exelon 23a
Affiliated Computer Svcs. 19b	Analog Devices 20e	Baxter International 14a	Capital One Financial 11	CompuCom Systems 19b	Diebold 20c	Expeditors Intl. 18a
AFLAC 12	Anheuser-Busch 7a	BB&T 10	Cardinal Health 14b	Computer Associates 19c	Dillard's 5c	Express Scripts 14b
AGCO 16f	Anixter International 20c	Bear Stearns 11	Caremark Rx 14b	Computer Sciences 19b	Disney (Walt) 4	Exxon Mobil 9b
Agere Systems 20e	AnnTaylor Stores 5d	BearingPoint 19b	Carlisle 16e	Compuware 19c	Dole Food 7b	F
Agilent Technologies 20c	Anthem 14b	Beazer Homes USA 2a	CarlMax 5d	Converse Tech. 20a	Dollar General 5c	Fairchild Semiconductor 20d
Air Products & Chemicals 21a	ADL Time Warner 4	Becton, Dickinson 14a	Carnival 3	ConAgra Foods 7b	Dollar Tree Stores 5c	Family Dollar Stores 5c
Airborne 18a	Aon 12	Bed Bath & Beyond 5d	Casey's General Stores 6	Concord EFS 17	Dominion Resources 23a	Fannie Mae 11
Airgas 21a	Apache 9b	Bell Microproducts 19b	Caterpillar 16f	ConocoPhillips 9b	Donnelley (R.R.) 17	Federated Dept. Stores 5c
AK Steel Holding 21d	Apartment Investment 13	BellSouth 22a	CBRL Group 3	Consolidated Edison 23a	Dover 16f	FedEx 18a
Alaska Air Group 18b	Apple Computer 20b	Belo 4	CDI 17	Constellation Brands 7a	Dow Chemical 21a	Ferro 21a
Alberto-Culver 8b	Applied Biosystems 14a	Bemis 21c	CDW Computer Centers 5d	Constellation Energy 23a	Dow Jones 4	Fidelity National Finl. 12
Albertson's 6	Applied Industrial Tech. 16g	Benchmark Electronics 20c	Cendant 17	Continental Airlines 18b	DPL 23a	Fifth Third Bancorp 10
Alcoa 21d	Aquila 23c	Berkley (W.R.) 12	CenterPoint Energy 23a	Convergys 17	DQE 23a	First American 12
Allegheny Energy 23a	Aramark 17	Berkshire Hathaway 12	CenturyTel 22a	Cooper Cameron 9a	Dreyer's Grand Ice Cream 7b	First Data 17
Allegheny Tech. 21d	Arch Coal 21d	Best Buy 5d	Ceridian 17	Cooper Industries 16d	DTE Energy 23c	First Tennessee Natl. 10
Allergan 15b	Archer Daniels 7b	Beverly Enterprises 14b	Champion Enterprises 2a	Cooper Tire & Rubber 1a	Duke Energy 23a	First Virginia Banks 10
Allete 23a	Arkansas Best 18d	Big Lots 5c	Charming Shoppes 5d	Coors (Adolph) 7a	Dun & Bradstreet 17	FirstEnergy 23a
Alliant Energy 23a	Arrow Electronics 20c	Biomet 14a	Charter Communications 4	Corn Products Intl. 7b	DuPont 21a	FirstMerit 10
Alliant Techsystems 16a	ArvinMeritor 1a	BJ's Wholesale Club 5c	Charter One Financial 10	Corning 20a	Dura Automotive Systems 1a	Fiserv 17
Allied Waste Inds. 17	Asbury Automotive 5d	Black & Decker 2a	ChevronTexaco 9b	Countrywide Finl. 11	Dynegy 23c	Fisher Scientific 14a
Allmerica Financial 12	Ashland 9b	Black Hills 23a	Chubb 12	Coventry Health Care 14b		FleetBoston Financial 10
Allstate 12	Associated Banc-Corp 10	Block (H&R) 17	Ciena 20a	Cox Communications 4		Fleetwood Ents. 2a
Alltel 22a	Astoria Financial 10	Blockbuster 5d	Cigna 14b	Crane 16f		Fleming 6
Amazon.com 5b	AT&T 22a	Blyth 2a	Cincinnati Financial 12	Crompton 21a		Flowers Foods 7b
AMC Entertainment 4	AT&T Wireless 22b	BMC Software 19c	CiNergy 23a	Crown Cork & Seal 21c		Flowserve 16f
Amerada Hess 9b	ATA Holdings 18b	Boeing 16a	Cintas 17	CSK Auto 5d		Fluor 16c
Ameren 23a	Atmel 20e	Boise Cascade 21e	Circuit City Stores 5d	CSX 18d		FMC 21a
America West Holdings 18b	Autoliv 1a	BOK Financial 10	Cisco Systems 20a	Cummins 16f		FMC Technologies 9a
American Aile & Mfg. 1a	Automatic Data 17	Borders Group 5d	Citigroup 11	CVS 6		Foot Locker 5d
American Eagle Outfitters 5d	AutoNation 5d	BorgWarner 1a	Citizens Commun. 22a	Cytec Industries 21a		Footstar 5d
American Electric 23a	AutoZone 5d	Boston Scientific 14a	City National 10			Ford Motor 1b
	Avaya 20a	Bowater 21e	CKE Restaurants 3			Forest Laboratories 15b
	Avery Dennison 17	Briggs & Stratton 16f	Clayton Homes 2a			Fortune Brands 2a
	Avista 23c	Brinker International 3	Clear Channel Commun. 4			Fox Entertainment 4
	Avnet 20c		Clorox 8a			FPL Group 23a

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OVERALL
★★★★★

THREE YEAR
★★★★★

FIVE YEAR
★★★★★

TEN YEAR
★★★★★

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[†]Source: MORNINGSTAR[®] 10/31/02. Past performance does not guarantee future results. For each fund with at least a three-year history, Morningstar calculates a Morningstar Rating[™] based on a Morningstar Risk-Adjusted Return measure that accounts for variation in a fund's monthly performance (including the effects of sales charges, loads and redemption fees), placing more emphasis on downward variations and rewarding consistent performance. The top 10% of funds in each category receive 5 stars, the next 22.5% receive 4 stars, the next 35% receive 3 stars, the next 22.5% receive 2 stars and the bottom 10% receive 1 star. (Each share class is counted as a fraction of one fund within this scale and rated separately, which may cause slight variations in the distribution percentages.) The Overall Morningstar Rating for a fund is derived from a weighted-average of the performance figures associated with its three-, five- and ten-year (if applicable) Morningstar Rating metrics. Morningstar Rating is for Class A shares only; other classes may have different performance characteristics. ©2002 Morningstar, Inc. All Rights Reserved. The information contained herein is proprietary to Morningstar and/or its content providers; may not be copied or distributed; and is not warranted to be accurate, complete or timely. Neither Morningstar nor its content providers are responsible for any damages or losses arising from any use of this information. For more current performance information, please call Franklin Templeton Investments at 1-800-342-5236.

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ALPHABETICAL LIST OF COMPANIES

The number following each company name identifies the Scoreboard category under which it is listed

Franklin Resources 11
Freddie Mac 11
Freeport-McMoRan C&G 21d
Fresh Del Monte 7b
Frontier Oil 9b
Fuller (H.B.) 21a
Furniture Brands 2a

G

Gannett 4
Gap 5d
Gateway 20b
GATX 18d
GenCorp 16a
Genentech 15a
General Cable 16d
General Dynamics 16a
General Electric 16e
General Mills 7b
General Motors 1b
Genesis Health 14b
Gentiva Health Svcs. 14b
Genuine Parts 5a
Georgia Gulf 21a
Georgia-Pacific 21e
Gevity HR 17
Gillette 8b
Golden West 10
Goldman Sachs Group 11
Goodrich 16a
Goodyear Tire & Rubber 1a
Grainger (W.W.) 16g
Granite Construction 16c
Great A&P 6
Great Lakes Chemical 21a
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GreenPoint Financial 10
Greif Bros. 21c
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H

Halliburton 9a
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Harley-Davidson 1b
Harman International 2a
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Hartford Financial Services 12
Hasbro 2b
Hawaiian Electric 23a
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Health Net 14b
HealthSouth 14b
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Hershey Foods 7b
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Home Depot 5d
HON Industries 17
Honeywell Intl. 16a
Hormel Foods 7b
Horton (D.R.) 2a
Household Intl. 11
Hovnanian Ents. 2a
Hubbell 16d
Hughes Electronics 4
Hughes Supply 5d
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Hunt (J.B.) 18a
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Illinois Tool Works 16f
Imation 20b
IMC Global 21a
IMS Health 14b

Ingersoll-Rand 16f
Ingram Micro 20c
Insight Enterprises 5b
Instinet Group 11
Integrated Electrical Svcs. 16c
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ITT Industries 16f
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Jacobs Engineering 16c
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John Hancock Financial 12
Johnson & Johnson 15b
Johnson Controls 1a
Jones Apparel Group 2c

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Lennar 2a
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Lilly (Eli) 15b
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Lincoln National 12
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Lithia Motors 5d
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MPS Group 19b
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National Commerce Finl. 10
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National-Oilwell 9a
Nationwide Financial Svcs. 12
Navistar International 16f
NCR 20b
Neiman Marcus Group 5c
New Jersey Resources 23b
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Newell Rubbermaid 21a
Newmont Mining 21d
Nextel Communications 22b
Nicor 23b
Nike 2c
NiSource 23b
Noble Energy 9b
Nordstrom 5c
Norfolk Southern 18d
North Fork Bancorp. 10
Northeast Utilities 23a
Northern Trust 10
Northrop Grumman 16a
Northwest Airlines 18b
Northwestern 23c
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NSTAR 23a
Nucor 21d
NVIDIA 20e
NVR 2a

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Old Republic Intl. 12
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OM Group 21a
Omnicare 14b
Omnicom Group 4
ON Semiconductor 20e
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PC Connection 5d
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Pittston 17
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PPG Industries 21a
PPL 23a
Praxair 21a
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Provident Financial 10
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PSS World Medical 14b

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Puget Energy 23a
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Robert Half International 17
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Rockwell Automation 16d
Rockwell Collins 16a
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Ross Stores 5d
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Ruddick 6
Russell 2c
Ryder System 18a
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Saks 5c
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Smithfield Foods 7b
Smurfit-Stone Container 21c
Snap-on 2a
Solectron 20c
Solutia 21a
Sonic Automotive 5d

Sonoco Products 21c
Southern 23a
Southern Union 23b
SouthTrust 10
Southwest Airlines 18b
Southwest Gas 23b
Sovereign Bancorp 10
Spherion 17
Sports Authority 5d
Sprint FON Group 22a
Sprint PCS Group 22b
SPX 16f
St. Jude Medical 14a
St. Paul 12
StanCorp Financial Group 12
Standard Pacific 2a
Stanley Works 2a
Staples 5d
Starbucks 3
Starwood Hotels & Resorts 3
State Street 11
Steelcase 17
Stein Mart 5c
Stewart & Stevenson 16f
Stewart Information Svcs. 12
Stilwell Financial 11
Storage Technology 20b
Stryker 14a
Sun Microsystems 20b
SunGard Data Systems 19b
Sunoco 9b
SunTrust Banks 10
Supervalu 6
Swift Transportation 18d
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Sysco 6

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Talbots 5d
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Teleflex 16e
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United Technologies 16a
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Universal Forest Products 1
Universal Health 14b
Unocal 9b
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US Oncology 14b
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V

Valero Energy 9b
Valspar 21a
Varco International 9a
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Verizon Communications 2
VF 2c
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Viad 17
Vishay Intertechnology 20c
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Wachovia 10
Walgreen 6
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Washington Mutual 10
Washington Post 4
Waste Management 17
Watson Pharmaceuticals 1
Weatherford Intl. 9a
WellPoint Health 14b
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Wendy's Intl. 3
Werner Enterprises 18d
WESCO International 5a
Western Digital 20b
Western Gas Resources 9b
Weyerhaeuser 21e
WGL Holdings 23b
Whirlpool 2a
Whole Foods Market 6
Williams 23c
Williams-Sonoma 5d
Winn-Dixie Stores 6
Wisconsin Energy 23a
Worthington Inds. 21d
WPS Resources 23a
Wrigley (Wm.) Jr. 7b
Wyeth 15b

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Xcel Energy 23a
Xerox 20d
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HEALTH HORIZONS

NEWS FOR YOUR WELL-BEING



Prevention: It starts with you

U.S. Surgeon General
Richard H. Carmona, MD

Do you know the fastest-growing cause of illness and death in America today? The answer may surprise you. It is not smoking, drug abuse, or alcoholism, as terrible as those things are. It is being overweight or obese.

Nearly two out of three of all Americans are overweight or obese: that's a 50% increase from just a decade ago! Nearly 15% of our children and teenagers are overweight; and overweight children usually grow up to be overweight adults.

Being overweight and obese invites a host of health problems, including diabetes, certain types of cancer, stroke, and heart attack.

The cost of these illnesses is high. Personal costs include lost opportunities, disability, death and grieving for those who suffer with them and their families. The economic costs are also high – stretching into the hundreds of billions of dollars – for the businesses and government paying health insurance costs and who must compensate for the lost productivity of workers, managers, and executives not minding their own health.

If we would step back a moment we would realize the enormous burden –

and suffering – of most illnesses is largely preventable. As Surgeon General, America's doctor, my top priority can be summed up in one word: prevention.

Exercise. Eat right. Get plenty of sleep. And avoid alcohol and tobacco. This is the good health recipe used for generations. It's not exciting; it's not dramatic. But it has proven effective for preventing illness.

Small steps can bring big rewards. You don't have to run miles and miles to benefit from exercise; start with walking from a space at the back of the parking lot, washing the car, or playing with the kids. Encourage the kids to turn off the Play Station and head out to the playground.

You don't have to starve yourself to lose weight. Start by avoiding fast food once or twice a week. I'll be the first to say it won't be easy. Families live such busy lives now, and it is much easier when mom and dad come home from work exhausted simply to pop a TV dinner into the microwave or order a pizza than it is to prepare a healthy meal.

Besides, let's face it, sometimes a big order of french fries is much more appealing than say, a garden salad.

But the small choices we make today – every day – will last a lifetime. We can bring ourselves health or sickness by the choices we make. It's that simple.

For good ideas and simple steps you can take to become healthier, check out www.healthierus.gov.

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Nutrition and eye health

Johanna M. Seddon, MD

By the year 2030, an estimated 70 million Americans will be 65 or older, and for many, deteriorating eye health will be a serious concern. There is growing evidence that specific nutrients may help protect against the two leading causes of visual impairment and blindness in American adults: cataracts and age-related macular degeneration (AMD). Vitamins C and E and the carotenoids lutein and zeaxanthin have been linked in scientific studies to a reduced risk for AMD and, to a lesser extent, cataracts.

Cataracts

About 20 million Americans have cataracts, opacities in the lens of the eye that cause clouded vision or blindness. They are caused in part by oxidative damage to lens proteins from years of exposure to ultraviolet light. Cataract extractions are the most common surgical procedure performed in the U.S. and the most costly item on the Medicare budget. Epidemiologists estimate that if the progression of cataracts could be delayed by 10 years, the number of surgeries might be reduced by 45%.

Vitamins C and E, both powerful antioxidants, may play a role in protecting against the oxidative damage that causes

cataracts. The data are mixed. A number of observational studies have correlated higher levels of these vitamins with reduced risk of cataract, particularly in people who took supplements for more than ten years. However, of the two clinical trials that have been conducted on vitamins and cataracts, only one showed benefit.

THE COLORS OF GOOD HEALTH

A rainbow of pigments in plants may play beneficial roles in health. Good colors for eye health are dark green vegetables, such as spinach, kale, broccoli, peas and Brussels sprouts, and yellow and orange fruits and vegetables such as corn, orange juice, yellow summer squash, and orange peppers. They contain "lutein" and "zeaxanthin," both found in research studies to protect against age-related eye diseases.

Age-Related Macular Degeneration (AMD)

AMD, a loss of central vision due to breakdown of cells in the retina, affects about a quarter of Americans over 65. Prevention is extremely important because treatment options are quite limited. Recently the National Eye Institute (NEI) completed a clinical trial, the Age-Related Eye Disease Study (AREDS), that showed dietary supplements delayed the progression of advanced AMD. The investigators concluded that persons older than 55 years with intermediate to late vision loss due to AMD should consider taking a supplement such as that used in the trial (500 mg vitamin C, 400 IU vitamin E, 15 mg beta carotene, 80 mg zinc, 2 mg copper).

Lutein and zeaxanthin may hold even more promise for AMD. These two yellow-colored nutrients are concentrated in an area of the retina called the macula lutea, so named because it literally means "yellow spot." The unique concentration of lutein and zeaxanthin in the retina suggests a specific role in the eye. In two large studies at Harvard

people with the highest dietary intakes of lutein and zeaxanthin (greater than 5.8 mg per day) had a significantly lower AMD risk compared to those with the lowest intakes (approximately 1.2 mg per day). The average diet in the U.S. contains less than 2.0 mg of lutein and zeaxanthin combined.

Obtaining the Needed Nutrients

Diets providing five to nine daily servings of fruits and vegetables that include lutein- and zeaxanthin-rich choices can provide close to the 6 mg level that research has found to be protective. It is also possible to get substantial amounts of vitamin C (about 250 mg from a daily diet rich in fruits and vegetables, although it is much more difficult to reach potentially protective levels of vitamin E (typical diets in the U.S. contain only about 10.5 IU of vitamin E). Increased intake of fruits and vegetables has been promoted to the American public for a variety of health benefits. Maintaining eye health as we age adds one more good reason to meet this goal.

Dr. Seddon is a retina specialist and Director of the Epidemiology Unit at the Massachusetts Eye and Ear Infirmary, teaching affiliate of the Harvard Medical School. She is nationally known for her research of eye diseases and has been a pioneer and lead investigator for several nutritional studies, including the recent NEI AREDS study.



When it comes to healthy vision, keep an eye on Lutein and Zeaxanthin.

You may be aware of the potential benefits of vitamins C and E in helping to reduce the risk of cataracts, but you may not have heard of Lutein or Zeaxanthin. Scientists have been studying their potential benefits for years.

These two carotenoids are commonly found in vegetables such as spinach, kale and corn.

While more research is needed, several lines of evidence suggest that high intakes of foods rich in Lutein and Zeaxanthin can reduce the risk of age-related macular degeneration (AMD) and cataracts, which are the leading causes of blindness in the world.

In addition to a proper diet, a healthy regimen should include regular visits to your eye doctor,

and of course, regular medical checkups, not smoking and routine exercise.

For more information, please call 1-877-687-6243.



Your annual health evaluation: It's time to expect more!

James M. Rippe, MD and
John G. Langdon, MD

The fast-paced executive lifestyle, filled with pressures, long hours, interruptions, and frequent travel, poses heightened risks to the health and well-being of key executives. Understanding this threat, companies and executives alike increasingly choose an annual executive health evaluation as a key tool for protecting their investment in leadership.

Clinics such as ours provide state of the art health evaluations for executives. But, regardless of your corporate stature, a thorough annual health check-up will improve your chances for a long and healthy life. What should a model annual executive health assessment contain? The best health evaluations deliver "high-touch" and "high-tech" state-of-the-art medicine and lifestyle consultation. Here is a good guide, based on what we do at Rippe Health Assessment, for what to expect and what to ask for from your own physician.

Your History

The best evaluation begins face-to-face. What the executive tells the physician in discussing health history, lifestyle, and risk-factor issues and what we discover in a hands-on physical examination and lab work tell us how to focus precision high-tech screening for maximum benefit.

In addition to emphasis on health history and risk factors for heart disease and cancer (the leading health risks for executives over age 30), we explore personal and family issues that might be creating stress or hindering performance.

To enhance total well-being and vitality, this assessment focuses on stress reduction, sources of emotional strength, and strategies for achieving maximum performance. Quantity and quality of sleep, friendships, family relationships and other restorative factors are also assessed.

Your Physical Exam

The physical examination should include vital signs, complete evaluation of the head, eyes, ears, nose and throat, heart and lungs, abdomen, full skin evaluation with the patient disrobed, thorough musculoskeletal examination, genital, and rectal examination. In addition, men require prostate and testicular examination and women breast and pelvic exam.

Complete blood and urine evaluations, including blood count, metabolic profiles and fasting lipid profile, provide baselines. In addition, we evaluate thyroid function, C-Reactive Protein (CRP) as an early indication of cardiac risk, and, in men, Prostate Specific Antigen (PSA) as a possible indicator of prostate cancer.

Among high-tech screening techniques, High-Speed Heart CT Scans on men over 40 and women over 45 provide a highly accurate assessment and early warning signal of the presence of chronic atherosclerosis in the coronary arteries.

YOUR MEDICINE CABINET

Over half of all executives we see are taking prescription drugs and one or more supplements and/or vitamins - often with unintended side effects or interactions. A pharmacy assessment not only identifies potential problems but recommends the most effective options for individual patients.

For former or current smokers, a High-Speed Helical CT Scan of the lungs can detect lung cancer when it is still treatable. We recommend colonoscopy starting at 45, or earlier if a family history of colon cancer exists. And, computer-assisted digital mammography and bone density assessment are important for women.

A thorough exam also includes exercise treadmill testing, direct measurement of metabolic rate, body composition analysis, as well as hearing and vision tests.

Your Report

A comprehensive counseling session and complete report should round out the annual executive evaluation. Using high-touch and high-tech diagnostics it is possible not only to detect disease at their earliest stages, but also to develop specific, individualized plans to prevent disease. As needed, access should be provided to specialists for any specific or complex medical problems identified.

Business executives, managers, and other successful professionals achieve their positions by effectively analyzing and acting on data, not by being passive. It's time to think of your health assessment as a springboard to better health and higher performance. It's time to expect more!

YOUR LIFESTYLE:

NUTRITION, EXERCISE, AND WEIGHT MANAGEMENT

In the executive population we see at Rippe Health Assessment, over 70 percent of clients do not get enough regular exercise to achieve health benefits. A comprehensive physical activity/fitness assessment with a detailed plan of action addresses this need.

Too many physicians and patients ignore the importance of nutrition and weight management. Eight of the ten leading causes of death in the United States each year have a nutrition or alcohol component. Over 60 percent of the patients we see are overweight or obese. A detailed nutrition evaluation, including analysis of a three-day food record, is essential and informs a customized nutritional and weight management plan.

Dr. Rippe and Dr. Langdon are, respectively, Founder/Director and Medical Director, Rippe Health Assessment Florida Hospital Celebration Health. For more information, see www.ripphealth.com.

Men – it might be your hormones

Winston K. Mebust, MD

For decades, women expected and tolerated menopause and its side effects. Hormone replacement therapy gave women a powerful tool to treat the symptoms of diminished estrogen levels. In recent years another question has arisen: Do aging men undergo a similar change as male hormone levels decline with age?

Commonly known as "male menopause" or andropause, hypogonadism has started making headlines around the world, though researchers are still trying to determine the mechanisms behind dwindling hormone levels and aging. More men than ever before are visiting the doctor with low energy levels and decreased libido. For some, abnormally low testosterone levels may be the cause.

Male hypogonadism – the condition in which the testes do not function at optimum levels – most often results from natural aging but may also be related to familial history, nutritional problems, or cancer. Besides diminished sex drive and energy,

THE AMERICAN UROLOGICAL ASSOCIATION (AUA) strongly supports the need for more research on the causes and treatment of low testosterone. The AUA believes in informed patient decision-making and careful medical surveillance when treating hypogonadism. Men should talk to their urologist about their condition, its effects and ways of possible treatment. For more information see the AUA's patient education web site, www.urologyhealth.org.

its side effects may be similar to those of menopause: changes in mood, irritability, breast tenderness, reduced muscle mass and strength, headaches, and loss of bone density (osteoporosis). It is important to remember that declining hormone levels are a natural part of the aging process and that not all men will have symptoms severe enough to warrant treatment.



Because women have a clear signal indicating menopause – that is, the end of menstrual cycles – declining hormone levels are easier to identify in women. Moreover, the condition in men can sometimes span decades, which also makes it more difficult to diagnose. If you are an aging male experiencing severe menopause-like symptoms, it is important to visit your primary care physician who may refer you to a specialist familiar with the condition. With a simple blood test, a urologist or hormone specialist can evaluate if hormone levels are to blame for your symptoms or caused by another health condition.

Replacing testosterone is one way to combat the symptoms of hypogonadism. Clinical studies have shown that treatment can be successful for certain individuals. However, it is not to be entered into lightly, and not all men are candidates. Though the weight of current evidence does not suggest excessive risk of heart disease or prostate cancer, the fact is that the benefits and risks of long-term testosterone replacement therapy (TRT) have not been definitively established. Testosterone can fuel existing prostate tumors and exacerbate other conditions, so it is important to be thoroughly evaluated by a physician before beginning any type of hormone replacement.

Even after evaluation, it is important that patients make informed decisions about

their condition, its effects and ways of treatment. If TRT is prescribed, patients should be carefully supervised by their physicians, and should be seen regularly to evaluate overall health.

Dr. Mebust is president of the American Urological Association, a professional association with more than 15,000 members worldwide.

PROSTATE SCREENING: IS IT TIME TO START?

Approximately 30,000 men will die this year from prostate cancer, but many of those deaths might have been avoided with early diagnosis and treatment. The Prostate-Specific Antigen blood test is a simple diagnostic that can be easily performed as part of a yearly physical. Prior to the use of the PSA test, prostate tumors were found mostly in advanced – and less treatable – stages, and patients had far fewer options for treatment than they have today.

The American Urological Association believes that all men over 50 – and those over 45 at high risk, such as African-Americans and men with a family history of prostate cancer – should consider the test and discuss its benefits and limitations with their physicians.



Safety Information: Adverse events possibly, probably or definitely related to use of AndroGel® in the controlled trial (n=154) across all dose levels reported in at least 2% of patients included lab test abnormal 5.8%, acne 5.2%, application site reaction 5.2%, prostate disorder 4.5%, headache 2.6%, and hypertension 2.6%.

• Adverse events possibly, probably or definitely related to use of AndroGel in a 1-year follow up (n=106) across all dose levels reported in at least 2% of patients included application site reaction 9.4%, prostate disorder 8.5%, acne 5.7%, and lab test abnormal 4.7%.



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• Androgens are contraindicated in men with cancer of the breast, or known or suspected carcinoma of the prostate. Geriatric patients treated with androgens may be at an increased risk for the development of hyperplasia and prostatic carcinoma.

• To minimize the potential transfer of testosterone to another person, patients should wash their hands immediately with soap and water after application of AndroGel. They should cover the application site with clothing after the gel has dried.

Please see brief summary of prescribing information.

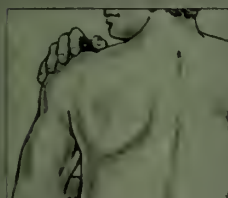
Fatigued?

Depressed mood?

Low sex drive?

Could be your testosterone is running on empty.

An estimated 4-5 million American men have a medical condition called hypogonadism, or low testosterone.¹ These low testosterone levels can cause a number of different symptoms such as low sex drive, fatigue, depression, and even loss of height or strength. Your doctor can check your testosterone level with a simple blood test.



Fortunately you can replace testosterone with AndroGel[®] which delivers natural testosterone in a gel that you simply rub into your skin – no patches or injections. As it's absorbed through your skin, AndroGel treats hypogonadism by restoring your testosterone to its normal range.

1. www.fda.gov/fdac/departs/196_upd.html, accessed May 17, 2002

Ask your doctor if AndroGel is right for you.

For more information please visit:

www.androgel.com or call **1-800-241-1643**



Testosterone restored



AndroGel®

(testosterone gel) 1% CIII

INDICATIONS AND USAGE

AndroGel® is indicated for replacement therapy in males for conditions associated with a deficiency or absence of endogenous testosterone:

1. Primary hypogonadism (congenital or acquired)—testicular failure due to cryptorchidism, bilateral torsion, orchitis, vanishing testis syndrome, orchiectomy, Klinefelter's syndrome, chemotherapy, or toxic damage from alcohol or heavy metals. These men usually have low serum testosterone levels and gonadotropins (FSH, LH) above the normal range.
2. Hypogonadotropic hypogonadism (congenital or acquired)—idiopathic gonadotropin or luteinizing hormone-releasing hormone (LHRH) deficiency or pituitary-hypothalamic injury from tumors, trauma, or radiation. These men have low testosterone serum levels but have gonadotropins in the normal or low range.

AndroGel® has not been clinically evaluated in males under 18 years of age.

CONTRAINDICATIONS

Androgens are contraindicated in men with carcinoma of the breast or known or suspected carcinoma of the prostate.

AndroGel® is not indicated for use in women, has not been evaluated in women, and must not be used in women.

Pregnant women should avoid skin contact with AndroGel® application sites in men. Testosterone may cause fetal harm. In the event that unwashed or unclothed skin to which AndroGel® has been applied does come in direct contact with the skin of a pregnant woman, the general area of contact on the woman should be washed with soap and water as soon as possible. *In vitro* studies show that residual testosterone is removed from the skin surface by washing with soap and water.

AndroGel® should not be used in patients with known hypersensitivity to any of its ingredients, including testosterone USP that is chemically synthesized from soy.

WARNINGS

1. Prolonged use of high doses of orally active 17-alpha-alkyl androgens (e.g., methyltestosterone) has been associated with serious hepatic adverse effects (peliosis hepatis, hepatic neoplasms, cholestatic hepatitis, and jaundice). Peliosis hepatis can be a life-threatening or fatal complication. Long-term therapy with testosterone enanthate, which elevates blood levels for prolonged periods, has produced multiple hepatic adenomas. Testosterone is not known to produce these adverse effects.
2. Geriatric patients treated with androgens may be at an increased risk for the development of prostatic hyperplasia and prostatic carcinoma.
3. Geriatric patients and other patients with clinical or demographic characteristics that are recognized to be associated with an increased risk of prostate cancer should be evaluated for the presence of prostate cancer prior to initiation of testosterone replacement therapy. In men receiving testosterone replacement therapy, surveillance for prostate cancer should be consistent with current practices for eugonadal men (see PRECAUTIONS: Carcinogenesis, Mutagenesis, Impairment of Fertility and Laboratory Tests).
4. Edema with or without congestive heart failure may be a serious complication in patients with preexisting cardiac, renal, or hepatic disease. In addition to discontinuation of the drug, diuretic therapy may be required.
5. Gynecomastia frequently develops and occasionally persists in patients being treated for hypogonadism.
6. The treatment of hypogonadal men with testosterone esters may potentiate sleep apnea in some patients, especially those with risk factors such as obesity or chronic lung diseases.

PRECAUTIONS

Transfer of testosterone to another person can occur when vigorous skin-to-skin contact is made with the application site (see Clinical Studies). The following precautions are recommended to minimize potential transfer of testosterone from AndroGel®-treated skin to another person:

- Patients should wash their hands immediately with soap and water after application of AndroGel®.
- Patients should cover the application site(s) with clothing after the gel has dried (e.g., a shirt).
- In the event that unwashed or unclothed skin to which AndroGel® has been applied does come in direct contact with the skin of another person, the general area of contact on the other person should be washed with soap and water as soon as possible. *In vitro* studies show that residual testosterone is removed from the skin surface by washing with soap and water.

Changes in body hair distribution, significant increase in acne, or other signs of virilization of the female partner should be brought to the attention of a physician.

General

The physician should instruct patients to report any of the following:

- Too frequent or persistent erections of the penis.
- Any nausea, vomiting, changes in skin color, or ankle swelling.
- Breathing disturbances, including those associated with sleep.

Information for Patients

Advise patients to carefully read the information brochure that accompanies each carton of 30 AndroGel® single-use packets.

Advise patients of the following:

- AndroGel® should not be applied to the scrotum.
- AndroGel® should be applied once daily to clean, dry skin.
- After application of AndroGel®, it is currently unknown for how long showering or swimming should be delayed. For optimal absorption of testosterone, it appears reasonable to wait at least 5-6 hours after application prior to showering or swimming. Nevertheless, showering or swimming after just 1 hour should have a minimal effect on the amount of AndroGel® absorbed if done very infrequently.

Laboratory Tests

1. Hemoglobin and hematocrit levels should be checked periodically (to detect polycythemia) in patients on long-term androgen therapy.
2. Liver function, prostatic specific antigen, cholesterol, and high-density lipoprotein should be checked periodically.
3. To ensure proper dosing, serum testosterone concentrations should be measured (see DOSAGE AND ADMINISTRATION).

Drug Interactions

Oxyphenbutazone: Concurrent administration of oxyphenbutazone and androgens may result in elevated serum levels of oxyphenbutazone.

Insulin: In diabetic patients, the metabolic effects of androgens may decrease blood glucose and, therefore, insulin requirements.

Propranolol: In a published pharmacokinetic study of an injectable testosterone product, administration of testosterone cypionate led to an increased clearance of propranolol in the majority of men tested.

Corticosteroids: The concurrent administration of testosterone with ACTH or corticosteroids may enhance edema formation; thus, these drugs should be administered cautiously, particularly in patients with cardiac or hepatic disease.

Drug/Laboratory Test Interactions

Androgens may decrease levels of thyroxine-binding globulin, resulting in decreased total T4 serum levels and increased resin uptake of T3 and T4. Free thyroid hormone levels remain unchanged, however, and there is no clinical evidence of thyroid dysfunction.

Carcinogenesis, Mutagenesis, Impairment of Fertility

Animal Data: Testosterone has been tested by subcutaneous injection and implantation in mice and rats. In mice, the implant induced cervical-uterine tumors, which metastasized in some cases. There is suggestive evidence that injection of testosterone into some strains of female mice increases their susceptibility to hepatoma. Testosterone is also known to increase the number of tumors and decrease the degree of differentiation of chemically induced carcinomas of the liver in rats.

Human Data: There are rare reports of hepatocellular carcinoma in patients receiving long-term oral therapy with androgens in high doses. Withdrawal of the drugs did not lead to regression of the tumors in all cases.

Geriatric patients treated with androgens may be at an increased risk for the development of prostatic hyperplasia and prostatic carcinoma.

Geriatric patients and other patients with clinical or demographic characteristics that are recognized to be associated with an increased risk of prostate cancer should be evaluated for the presence of prostate cancer prior to initiation of testosterone replacement therapy.

In men receiving testosterone replacement therapy, surveillance for prostate cancer should be consistent with current practices for eugonadal men.

Pregnancy Category X (see Contraindications)—Teratogenic Effects: AndroGel® is not indicated for women and must not be used in women.

Nursing Mothers: AndroGel® is not indicated for women and must not be used in women.

Pediatric Use: Safety and efficacy of AndroGel® in pediatric patients have not been established.

ADVERSE REACTIONS

In a controlled clinical study, 154 patients were treated with AndroGel® for up to 6 months. Adverse events possibly, probably or definitely related to the use of AndroGel® and reported by ≥1% of the patients are listed in Table 1.

Adverse Event	5 g	7.5 g	10 g
Acne	1%	3%	8%
Alopecia	1%	0%	1%
Application Site Reaction	5%	3%	4%
Asthenia	0%	3%	1%
Depression	1%	0%	1%
Emotional Lability	0%	3%	3%
Gynecomastia	1%	0%	3%
Headache	4%	3%	0%
Hypertension	3%	0%	3%
Lab Test Abnormal*	6%	5%	3%
Libido Decreased	0%	3%	1%
Nervousness	0%	3%	1%
Pain Breast	1%	3%	1%
Prostate Disorder**	3%	3%	5%
Testis Disorder	3%	0%	0%

*Lab test abnormal occurred in nine patients with one or more of the following events: elevated hemoglobin or hematocrit, hyperlipidemia, elevated triglycerides, hypokalemia, decreased HDL, elevated glucose, elevated creatinine, or elevated total bilirubin.

**Prostate disorders included five patients with enlarged prostate, one patient with BPH, and one patient with elevated PSA results.

The following adverse events possibly related to the use of AndroGel® occurred in fewer than 1% of patients: amnesia, anxiety, discolored hair, dizziness, dry skin, hirsutism, host impaired urination, paresthesia, penis disorder, peripheral edema, sweating, and vasodilation.

In this clinical trial of AndroGel®, skin reactions at the site application were occasionally reported with AndroGel®, but none was severe enough to require treatment or discontinuation of drug.

Six (4%) patients in this trial had adverse events that led to discontinuation of AndroGel®. These events included the following: cerebral hemorrhage, convulsion (neither of which were considered related to AndroGel® administration), depression, sadness, memory loss, elevated prostate specific antigen and hypertension. No AndroGel® patients discontinued due to skin reactions.

In an uncontrolled pharmacokinetic study of 10 patients, had adverse events associated with AndroGel®; these were asthenia and depression in one patient and increased libido and hyperkinesia in the other. Among 17 patients in four clinical studies there was one instance each of acne, erythema and benign prostate adenoma associated with a 2.5% testosterone gel formulation applied dermally.

One hundred six (106) patients have received AndroGel® for up to 12 months in a long-term follow-up study for patients who completed the controlled clinical trial. The preliminary safety results from this study are consistent with those reported for the controlled clinical trial. Table 2 summarizes those adverse events possibly, probably or definitely related to the use of AndroGel® and reported by at least 1% of the total number of patients during long-term exposure to AndroGel®.

Table 2. Incidence of Adverse Events Possibly, Probably or Definitely Related to the Use of AndroGel® in the Long-Term, Follow-up Study

Adverse Event	Dose of AndroGel®		
	5 g	7.5 g	10 g
Lab Test Abnormal*	4.2%	0.0%	6.3%
Peripheral Edema	1.4%	0.0%	3.1%
Acne	2.8%	0.0%	12.5%
Application Site Reaction	9.7%	10.0%	3.1%
Prostate Disorder**	2.8%	5.0%	18.8%
Urination Impaired	2.8%	0.0%	0.0%

*Lab test abnormal included one patient each with elevated GGTP, elevated hematocrit and hemoglobin, increased bilirubin, worsened hyperlipidemia, decreased HDL, and hypokalemia.

**Prostate disorders included enlarged prostate, elevated results, and in one patient, a new diagnosis of prostate cancer; three patients (one taking 7.5 g daily and two taking 10 g daily) discontinued AndroGel® treatment during the long-term study because of such disorders.

DRUG ABUSE AND DEPENDENCE

AndroGel® contains testosterone, a Schedule III controlled substance as defined by the Anabolic Steroids Control Act. Oral ingestion of AndroGel® will not result in clinically significant serum testosterone concentrations due to extensive first-pass metabolism.

OVERDOSAGE

There is one report of acute overdosage by injection of testosterone enanthate; testosterone levels of up to 11,400 ng/dL were implicated in a cerebrovascular accident.

DOSAGE AND ADMINISTRATION

The recommended starting dose of AndroGel® 1% is 5 g delivering 5 mg of testosterone systemically, applied once daily (preferably in the morning) to clean, dry, intact skin on the shoulders and upper arms and/or abdomen. Upon opening the packets(s), the entire contents should be squeezed into palm of the hand and immediately applied to the application sites. Application sites should be allowed to dry for a few minutes prior to dressing. Hands should be washed with water and AndroGel® has been applied.

Do not apply AndroGel® to the genitals.

Serum testosterone levels should be measured approximately 14 days after initiation of therapy to ensure proper dosing; the serum testosterone concentration is below the normal range, or if the desired clinical response is not achieved, 1 daily AndroGel® 1% dose may be increased from 5 g to 7 g and from 7.5 g to 10 g as instructed by the physician.

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BOB'S BIGGEST BLOOPERS OF THE YEAR

BY ROBERT BARKER rb@businessweek.com

ONE EVER WENT broke underestimating the taste of the American public, H.L. Mencken famously said. To which I now add myself duty-bound to add: No one ever broke overestimating how much we really eat. I learned this too late. A little more than a year ago, by dint of financial analysis and a view on popular enthusiasms as jaded as Mencken's, I figured

that Weight Watchers International was bound to go plop. And, it rose from \$32 to \$50 (charts).

Which drags me to that most melancholy annual moment, Barker Portfolio's review of failed forecasts. I've looked at columns at least a year old and, cringing, examined

those that time and events have proved wrong. Weight Watchers, I'm afraid, isn't the only crow on that menu.

■ **INSTINET GROUP.** Parent Reuters Group sold shares of this pioneering electronic stock-trading service in a May, 2001, initial public offering. What appealed to me was that some shares came

from Hambrecht's "OpenIPO" online auction, a way to name your own price. A bid near \$7 a share seemed about right to me. But not enough others bid much higher, the IPO came at \$1. Anyone bidding \$7 would have missed out—on an ugly loss, it turns out. Within a year, Instinet sank below \$7 and today goes for half that. Competition and price-cutting reigned havoc: Through Sept. 30 of this year, Instinet lost \$623 million, after netting \$99 million a year earlier. Is a turnaround possible? Maybe. As the industry consolidates, "price competition is abated," CEO Ed Nicoll told me. Now, with Instinet's head down 37% in the past year, he sees black ink in 2003.

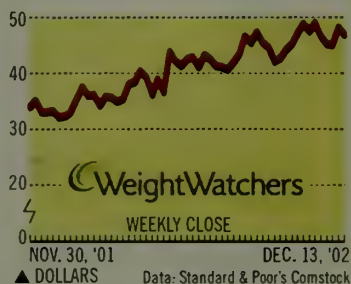
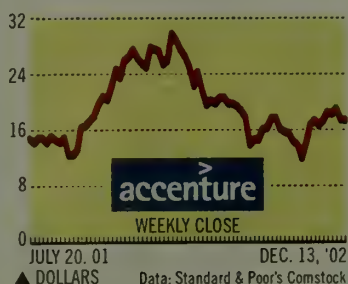
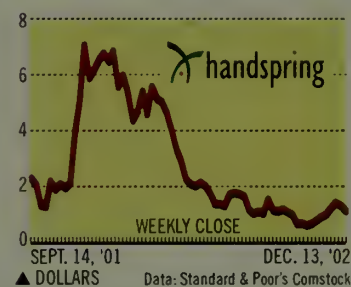
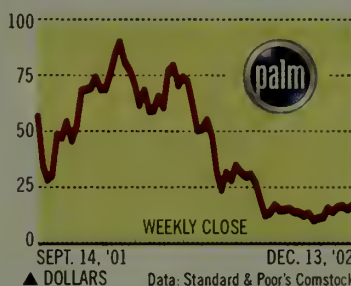
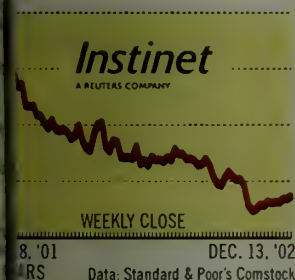
■ **ACCENTURE.** Once the man-ent and tech consulting firm of Arthur Andersen, Accenture went public in July, at \$14.50. This gave the company a market value 1.3 times its revenue, even as rival BearingPoint (since re-named BearingPoint) traded at 9 times revenue. That was risky to me. Yet Accen-

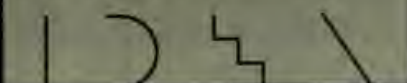
ture proved that rarity among recent tech-related new issues, dipping only briefly below its IPO price. As BearingPoint shares fell 45%, Accenture's last spring topped \$30 and today trade near \$18. Accenture was quick to cut staff as clients delayed projects. It also withheld \$140 million in accrued bonuses for the fiscal year ended Aug. 31.

■ **PALM AND HANDSPRING.** After noting the value apparent in these two makers of handheld computers in September, 2001, I

was pleased to see each stock jump within months (Palm up 74%; Handspring, 249%). Then, they crashed. Both fell below \$1, and Palm even had to do a 1-for-20 reverse stock split. That's why it trades near \$17 now. This was by no means the revival I had expected in the "Palm Economy," a network of software, computer, and telecom outfits that rely on the Palm OS, the leading operating system for handhelds. Both companies brought out some neat products, but pricing and demand remain weak. Instead of returning to profitability, as both companies expected this year, red ink keeps flowing. Meantime, their cash dwindles.

■ **WEIGHT WATCHERS.** Despite its precarious balance sheet—a danger I pointed out after its November, 2001, IPO—Weight Watchers walked through its first year as a public company with all the assurance of a runway model in high heels. Attendance at its weight-loss meetings rose 18% through September. As operating margins expanded, cash flow through the first three quarters surged 38%, helping Weight Watchers to begin trimming its debt. CEO Linda Huett told me that, barring acquisitions, she expects to have it paid off by 2005. With the stock now near \$47, Weight Watchers commands 29 times Wall Street's estimate of 2003 earnings. So its charms aren't wasted on investors, even if they were on me. From now on, though, I won't forget this fundamental truth: It's a Plus-size, Big Gulp, vain, vain, vain, vain world out there.





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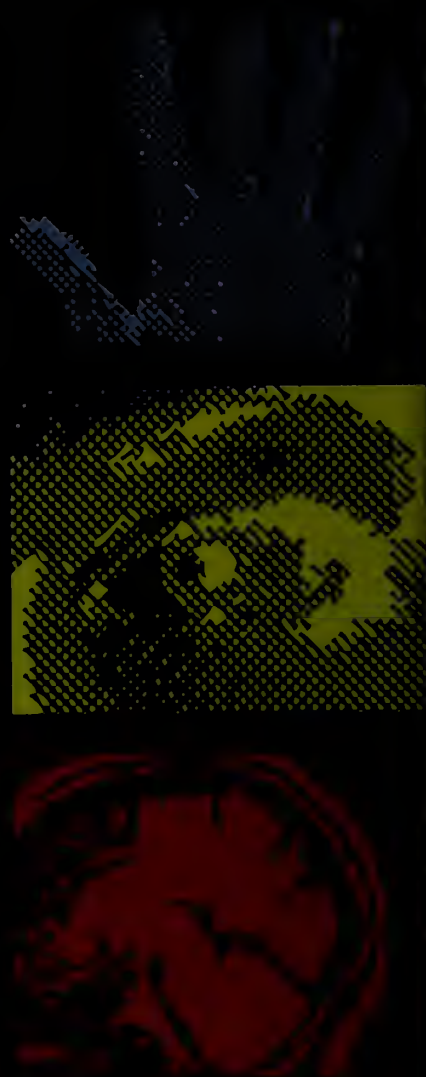
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— Bruce Nussbaum, H/IDSA, Design Editor at BusinessWeek



INVESTMENT & FINANCIAL PLANNING INSIGHTS FOR THE YEAR 2003

Buying Bonds – Risks Plus Rewards

buy bonds to be rewarded a good investment return. However, larger returns are typically associated with more risk, but risk that can be avoided or mitigated.

Interest rate or market risk. This is the risk that interest rates will move higher, and the price of your bonds will decline. This is only if you do not sell. If interest rates decline, the price of your bonds should

Reinvestment risk. If interest rates move higher, your interest payments when reinvesting will be less than the current interest rate. If interest rates decline, the coupon payments can be reinvested at that rate or higher. However, this is not possible if interest rates decline.

Call risk. Bonds can be called before maturity, usually when the issuer wants to refinance after interest rates decline. This means your cash

...larger returns are usually associated with more risk—but risk that can be avoided or mitigated."

won't be known beyond the call date, and you may not reinvest your principal at the lower rate. One way to mitigate this risk is to buy non-callable bonds. If you buy dis-

count bonds that are callable, you do not eliminate the call risk, but get a higher yield to call than yield to maturity.

4. Credit risk. The possibility that an issuer may default, and not meet principal and/or interest payments, can affect bond price. If an issuer appears more likely to default, bond prices



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most likely will decrease. Buying bonds expected to increase in credit quality can help mitigate this risk.

5. Inflation risk. As inflation increases, your bonds' fixed coupon and principal payments have less purchasing power. If you expect inflation to decline, invest in longer-term bonds to lock in rates you expect to decline; if you expect inflation to increase, you should do the opposite.

6. Liquidity risk. This is the possibility there may be few or no bidders on a bond. When you buy a bond with less liquidity, you should be rewarded with higher yields.

A wise investor buys bonds using a laddered approach, staggering bond maturities and diversifying by company, industry and geography, and thereby minimizing risk exposure.

Actively Managed Diversification: A Proven Strategy

The extreme volatility of the equity markets demonstrates that large, concentrated asset class bets do not stand the test of time. Growth stocks that fueled the historic returns of the late 90s have dramatically lagged all other asset classes over the subsequent three years. Fixed income and real estate, asset classes that were sidelined during the growth period, emerged as winners with positive rates of return while many growth stocks lost half their value, or more. And small cap value stocks handily outperformed growth and international equities on a relative basis. The lesson is that relative value in the market place will continue to rotate among asset classes in a fairly unpredictable fashion. See the chart below.

How does one capture this relative value without exposing the portfolio to undo risk? Overexposure to single asset classes is not the answer but neither is market timing. The cost of being wrong is unacceptably high. For example sitting in an all fixed income portfolio at today's historically low interest rate environment would not provide the return needed to meet the long term objectives of most investors. And bond values will decline as interest rates rise.

What is the answer? Actively Managed Diversification among various asset classes, including tilting the portfolio by increasing exposure to undervalued asset classes, and reducing exposure to overvalued ones.

The development of a broad-based asset allocation strategy with exposure to equities and fixed income, real estate and international,

venture funds and hedge funds, will help buffer the significant volatility in the market. Additionally, further diversification within equities between market caps (larger and smaller) and investment styles (growth and value) will enhance return and dampen volatility. The fixed income portion of the

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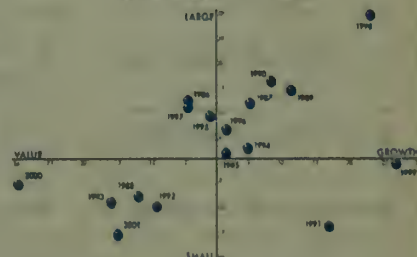
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portfolio can be refined as well. Attention to maturity ranges and quality of credits can enhance return and reduce risk.

Having experienced the longest bear market since the great depression, we are all looking for better

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Having a style bias towards either Growth, Value, Large or Small Cap stocks in a US equity portfolio would have had a big impact on performance over the last 17 years.

% performance differences for Russell 1000® Growth vs Russell 1000® Value and Russell 1000® Industrials

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returns in 2003. Regardless of market direction however, a thoughtfully managed, broadly diversified portfolio is the best way to achieve investment success over time.

INVESTMENT & FINANCIAL PLANNING INSIGHTS FOR THE YEAR 2003

Generating Income on Stock Holdings

Some investors are generating income during the current stock market decline. Their strategy: writing covered call options on stock holdings. Though options are generally thought of as complex tools used only by the pros, more and more individual investors are finding access to covered call options.

During the late-90's, the strategy was not popular as most investors opted to use the risky approach of buying options to augment returns rather than the income approach of selling options on current stock positions. However, they are gaining popularity during the current bear market.

In practice, covered call writing works well in down markets, flat markets, and slightly rising markets. Covered call writing can be an important component in a portfolio during most phases of an economic cycle, and it reduces portfolio volatility and increases current income on existing

as writing call options) that give other investors the option to buy the stock in their portfolios at a specified (strike) price for a specific period of time. In return, the investor is paid anywhere from 20 cents to many dollars per share today.



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Call for more information on how you can start generating income on your equity portfolio!

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For example, let's say you hold 500 shares of IBM at a current price of \$80. You sell another investor the right to buy your stock later at \$90. In return, you get \$8.80 per share generating \$4,400. If the stock falls, or if the stock remains unchanged, or if the stock moves higher but below 90, you keep the \$4,400. If the stock rises above 90, you keep the \$4,400 but lose some upside. The position generates 11% in income from the IBM stock with 23.5% total upside potential.

During the past 15 years, nearly 75% of the stock market gains have come on 1% of the trading days. The other 99% of trading days have been lower, flat, or slightly higher. Owning a stock is an exercise in patience waiting for the "1% days" to come around. Some investors are finding that collecting income during the other 99% can be very rewarding.

**"Owning a stock
is an exercise in
patience waiting
for the '1% days'
to come around."**

stock holdings. It is the only option strategy allowed in a retirement account.

Here is how it works: Investors sell contracts (known

The Style Grid - Problems and Alternatives

A style grid (Figure 1) in which stocks are classified as value or growth and ranked by size has become popular. Investors using the grid allocate investments across all six boxes, believing them to be six different asset classes, and hire six different specialty managers. Feedback from individual and institutional investors using this approach indicates mediocre returns. Ennis, Knupp & Associates, Inc. reports the results of a study by Cost Effective Measurement conducted in 1999 with 132 pension funds with aggregate assets of \$1.7 trillion. Over an eight-year period, the study found the average annual return for this multi-manager approach to be below a passive market benchmark by 1.4%.

There are four primary reasons that explain why this system is delivering disappointing returns. First, the six style boxes are not six different asset classes because their composition is not constant. In an article in the May 1, 2000, issue of Pensions and Investments, "Using Sector Rotation to Dissect Performance," it was demonstrated that industries and

Second, success of the entire grid approach is dependent on being able to predict performance when selecting specialty managers. Unfortunately, that is not possible. As the composition of a style grid changes, there is no correlation between past manager performance and future performance.



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	Value	Growth
Large Cap		
Mid Cap		
Small Cap		

Figure 1

their component stocks migrate around the style grid through time. Industries that are out of favor move down and left. Industries that are in favor move up and right. A style box cannot be an asset class if its composition is not stable through time. What is mid-cap value? It is not a thing or an entity. It is just a place on a grid where industries pass through.

Third, voids occur and opportunity is missed as managers avoid certain borderline stocks out of fear of being accused of style drift. The use of the grid results in artificiality as a manager may be forced to sell issues even though they may meet that manager's sell discipline.

The problems with the grid are hidden or tolerated during impressive rising markets. Its flaws are an incorrect assumption that the stock market is comprised of six asset classes are now being revealed. Many pension plans using the system have suffered losses and are now under funded. They recommend whole stock, all-cap portfolios and think they are better equipped to handle changing market themes and market cycles. Portfolios should be diversified among a few different managers with the freedom to buy anything that meets their system definition of market capitalization or growth characteristics.

INVESTMENT & FINANCIAL PLANNING INSIGHTS FOR THE YEAR 2003

Why Settle for Average in Your Investment Portfolio?

like the fictional children of Wobegon, all money managers are above average. Since the days of institutional and retail managers essentially constitute the stock market, they obviously cannot all outperform. Furthermore, the cost of management fees and transaction costs, significantly more than half of the actively managed assets must underperform the market in the long term.

For underperforming the broad market for most of the 1990s, active management appears to be staging a comeback. In the industry have announced this decade "stockpickers" marveled, the superior performance of the S&P 500 during the late 1990s might be attributed to the domination of cap stocks in the and full participa-

the technology bubble. In a growth environment with companies assuming leadership of the market, an S&P 500 possesses significant disadvantages. However, this does not mean selecting active managers any more. Without the tailwind of a double-digit market per-

record. Superior investment performance most often comes from an investment team motivated to perform by their passion for investing and their ownership of their firm and its investment process. The bureaucratic, asset retaining, marketing-oriented culture of most large financial institutions naturally



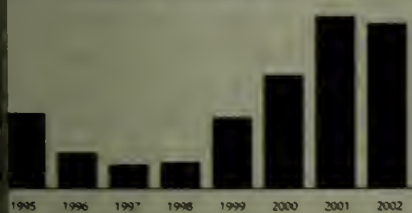
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Percentage of Equity Mutual Funds that outperformed the S & P 500 over the Prior Three Year Period



ce, poor investment choices and excessive fees will destroy an investor's ability to meet his or her goals.

Investors seeking above market returns should look for a financial manager that chooses smaller, entrepreneurial money managers and firms with a proven track

leads to closet indexing and mediocre investment performance. It is equally unlikely that superior performance will come from the same two dozen "wrap" managers that seem to appear in every brokerage separate account program.

Investors can obtain superior risk-adjusted performance by construct-

ing a diversified portfolio of the best money managers in each asset class. Serious investors require balanced portfolios with a style-neutral blend of quality equity

and fixed income managers, enhanced with an intelligent exposure to alternative asset classes such as private equity, hedge funds and real estate. Although market conditions can be as quick-changing as the weather, a well thought out game plan significantly increases an investor's chances of being above average.

Identifying Alpha: The Key to Portfolio Diversification

Since the dramatic decline of the U.S. Equity markets began in March 2000, few topics have received as much attention as portfolio diversification. But relatively few investors actually own diversified portfolios.

While many of the biggest losses suffered since March 2000 were in concentrated portfolios, even supposedly diversified equity portfolios suffered catastrophic losses as the NASDAQ fell over 70% and the S&P 500 dropped over 40%. Many investors feel that buying bonds is a way to diversify an equity portfolio. But, with rates as low as they now are, it is unlikely that bonds can continue to offer the level of returns seen over the past twenty years. Stocks and bonds

generating strategies. This independence allows for real diversification, making alpha a desirable characteristic. Moreover, there are many ways to generate alpha-driven returns, giving the investor many opportunities to diversify.

Market neutral alternative

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sensible components of a long-term investor's portfolio, but a diversified portfolio is designed to perform in many kinds of market environments.

In order to diversify, investors must seek returns that are independent of the direction of the

"In order to diversify, investors must seek returns that are independent of the direction of the market."

market. These "market neutral" returns can be found in the growing field of alternative investments.

Strategies producing returns that are independent of market direction are known as "alpha"

investments offer superior returns for the risks taken, when compared to traditional investments. There are a large and growing number of investment management firms that specialize in market neutral investing, and others that specialize in selecting portfolios of these market neutral strategies.

But the question remains: what produces alpha? Investment managers generating market neutral returns require some underlying "investment edge" in order to succeed. While there is no standardized recipe for an edge, some of the ingredients can certainly include investment experience, intelligence, investment process, and creativity. Because of the risks involved, correctly judging these and other factors is critical to the proper selection of market neutral investment opportunities. But the payoff, if well executed, is an all-weather portfolio that offers true diversification.

INVESTMENT & FINANCIAL PLANNING INSIGHTS FOR THE YEAR 2003

Creating A Family Legacy of Giving

Donating money to a worthy cause can be enormously satisfying. It can have a positive impact for years to come, and even prove to be an enduring legacy. However, many generous people don't realize their philanthropy can also offer them significant income and estate tax benefits. Taking a planned, longer-term approach to charitable giving may even allow your contributions to grow into a more substantial amount over time, increasing the impact of your gift.

Family philanthropy views wealth from a unique perspective. An estate (income plus net worth) consists of two parts . . . family capital and social capital. Family capital is the wealth an individual can spend between now and the time he or she dies and what can be given to heirs. It's the wealth that families get to keep! Social capital is the wealth that can't be spent before death nor

their social capital without giving up control of its use? Yes. A variety of planning options exist including two common methods: Family Foundations and Donor Advised Funds (DAFs). Due to the complexities and costs of managing and adminis-

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tering a family foundation, attention has been shifting in favor of DAFs.

DAFs provide a simple, flexible and cost-effective way to capture, manage, and distribute a family's social capital to charitable organizations of choice. They turn what would have been tax dollars used at the government's discretion into charitable dollars used by organizations whose missions and values reflect your own. Individuals give up their social capital but retain "virtual control" over its use.

Now, Americans have a choice about where their social capital goes, and how it's used. Because DAFs operate under the umbrella of a host public-charity that provides all of the administrative and reporting services, families can concentrate on the emotionally satisfying side of family philanthropy—seeing their generosity at work!

*"Now, Americans
have a choice
about where their
social capital goes,
and how it's used."*

given to heirs. Typically individuals give up their social capital in the form of taxes, a type of involuntary philanthropy, and let it go at that. But when they do, they also give up control of that wealth.

Are there alternatives – ways in which families can distribute

Breakthroughs in Science Deliver Success

Much needed, and long overdue, the client has regained his and her rightful place in the agendas of investment professionals. How do advisors truly and genuinely look out for the best interests of their clients? Sound investment strategies are key, and central to these strategies are the principles of Modern Portfolio Theory.

Modern Portfolio Theory (MPT) is the scientific approach to monitoring risk and estimating long-term achievable results. Beyond MPT, how do advisors uncover what the client really needs, wants, and expects (versus what they say they want)? Smart advisors need to not only understand the science behind securities, but are best prepared if they also understand the science behind the psychological behaviors of their clients. Therein lies the solution: the balance of these two scientific worlds.

Modern Portfolio Theory (MPT) comes from the work of Harry Markowitz. Originally published in 1952, he was recognized with the Nobel Peace Prize in Economics in 1990, acknowledging the role of science in the financial markets.

Rather than stock picking or beating the market, Modern Portfolio Theorists use statistical evaluations to understand the market and form asset allocation decisions. While MPT can be complex, simply put, portfolio selections are made based on historical performance and investor risk tolerance. Using tools of statistical analysis (standard deviation, correlation, covariance),

advisors quantify investment volatility as well as portfolio diversification, or lack thereof. This offers each investor the highest probability of a successful investment experience while eliminating the roller coaster ride of the portfolio's fluctuation.



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Whereas MPT provides the scientific vehicle for portfolio management, neuroscience analytics assist in determining clients' desired outcomes and risk tolerances. Through interviews and questionnaires, clients reveal preferences, anxieties and fears that are evaluated and translated into "client intelligence" data to be used in "investment intelligence" decisions. By focusing on "investment intelligence," advisors acquire an in-depth understanding and the ability to predict the needs, wants and values of each individual.

With Investment Intelligence and Client Intelligence, advisors use the best of scientific worlds assist them in creating comprehensive financial solutions, delivering client success and realization of life goals.

INVESTMENT & FINANCIAL PLANNING INSIGHTS FOR THE YEAR 2003

Using Tax Credits to Reduce your Income Tax Liability

Investments are a matter of
choice, but taxes are a matter
of fact.

If you are like most
Americans, taxes will be the
biggest expense that you will
pay over your lifetime...not

your mortgage, not
your education, but
your bill to the I.R.S.
Like most Ameri-
cans, you are probably
unaware of all the
tax strategies
available to you be-
cause many of them are
in investments, and
investments are out of
the scope of your CPA's
expertise. Tax credits
are one such invest-
ment, and if you have
not included tax credits
in your portfolio, you
may be missing an
important tax reduc-
tion strategy.

Tax credits are prefunded by
Congress, allocated at a prede-
termined rate and do not vary
with changes in interest rates or
fluctuations in the stock and
bond markets. Tax credits are
fully defined in Internal
Revenue Code,
Section 42, and
dollar-for-
dollar reduction
of taxes due,
with deferral of
payment for a de-
termined amount
against
e. Important
clarify the
importance be-
cause a tax de-
duction and a
credit. A tax
credit is a dol-
lar-dollar
reduction from
taxes due. For example,
if your tax bill is \$5,000 and
you have a tax credit of \$2,000,

you now owe only \$3,000. This
reduction can be as significant
as \$99,000 over a ten-year peri-
od. A deduction, on the other
hand, only reduces taxable
income. A tax credit is the more
efficient method to save tax dollars.



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not included tax
credits in your
portfolio, you
might be missing
an important tax
reduction
strategy."*

Most tax credits are used by
large corporations such as Bank
of America, AT&T, General
Mills and Microsoft to name a
few. Warren Buffet was actually
a leader in the use of tax credits
on the corporate level and bil-
lions of dollars have followed
his lead into
these programs.
These large cor-
porations used
their resources
to research tax
strategies and
found Federal
Housing Tax
Credits to be an
excellent way
to reduce their
taxes.

The tax breaks
that big corpo-
rations have been
utilizing for so
long are now
available to you, the individual
investor.

Risk and Return, But Don't Forget Taxes!

The market volatility the last
three years was a slap in the
face to many investors, remind-
ing them that the returns-crazy
years of 1995 through 1999
were not normal. It was a
painful education about the risk
component of the investment
equation. Of course, wise stew-
ards of financial assets
will pay close attention
to both variables in
their investment pro-
cess. However, the
loss-crazy years of
2000 through 2002
were equally abnormal,
a three-year nightmare
last seen in 1939
through 1941. Just as
returns blinded most
investors to risk, now
risk has blinded most
investors to taxes.

When the market
works its way out of
the doldrums, Uncle
Sam will be waiting.
Interest, dividends and short-
term capital gains will be taxed
at 44%; long-term capital gains
at 26%. Taxes have drifted from
the investment consciousness
of the American people. Now
is the opportune time for
investors to reposition their
portfolios for tax efficiency.

The starting point is estab-
lishing goals. What is the pur-
pose of the money? Retirement?
Is it to endow the edu-
cation and values of yet-unborn
great grandchildren? The in-
vestment time horizon will be
the most important single vari-
able in the investment process.

Once the time horizon has
been established, the focus
should shift to asset allocation.
The sophisticated investor will
use modern portfolio theory,
the source of two Nobel Prizes.
This will establish the most effi-
cient balance between risk and
return.

Taxes are next. Are all avail-
able "tax pockets" being used
effectively? IRAs and pensions
are best for retirement money.
For college, Section 529 ac-
counts should be considered.
For wealth transfer, life insur-
ance in an irrevocable trust
makes the most sense.

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FFR Advisory, LLC helps wealthy families to be
prudent stewards of their financial resources.
Financial success, while appealing in many
respects, creates its own burdens and compli-
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while helping them grow and protect their
wealth, and empower future generations.

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Next comes coordinating
the investment plan with the
tax plan. Investments with
short-term capital gains and
ordinary income usually are
best in IRAs and pensions.
Foreign tax credits are wasted
inside such accounts, so any
foreign stocks should be held
personally. Similarly, invest-
ments generating long-term
capital gains should be
held personally. Mutual fund
investments were a taxpayer's
worst nightmare in 2000, but
are no problem if held in
an IRA or pension. Private
money managers and individ-
ual stock holdings create
unique opportunities for tax-
efficient investing, and are
well suited for taxable
accounts.

INVESTMENT & FINANCIAL PLANNING INSIGHTS FOR THE YEAR 2003

Family Offices: What are the Benefits?

The first family offices were formed over 100 years ago by families of wealth in order to centralize the management of the families' financial affairs, while building a purchasing power base greater than family members could achieve on their own. Each family member benefits from a consolidated group

of professionals in the family office; investment and financial managers, estate planners, tax accountants, philanthropic administrators, and compliance personnel all dedicated to and knowledgeable about, each family's specific situation. It is estimated that there are over 2,500 family offices in the U.S., and even more informal family arrangements. A family office is usually created when (1) the liquid assets of the family grow to such a size that professional

management is required, separate from that which the family business professionals can provide, (2) the family business is sold creating liquidity, or (3) the family believes that their time and talents are better spent on other activities. A single-family office serves only one family, usually with assets in excess of \$100 million dollars. A multi-family office manages the financial affairs of more than one family and the asset requirement is considerably less than \$100 million. A family office differs from financial planners, investment managers, stockbrokers, bankers, and accountants in the services it provides – the full service family office not only plans, but also executes and manages, all of the financial affairs of a family over many generations.

The real value of a family office is coordination of the diverse financial aspects of family assets. By managing the entire investment process, family office professionals

have a better appreciation for what assets should be included in the family estate plan and charitable giving. They can budget family cash flow more efficiently, and can better tax plan and prepare tax returns than professionals outside the family office without access to all aspects of the financial affairs of

CYMRIC

Family Office Services

Cymric Family Office Services in an independent, full service family office. The firm's services include: asset allocation and investment management, financial management, tax planning and preparation, family meeting organization and facilitation, family foundation management, wealth transfer planning and trust administration, bill paying and cash flow management, and next generation financial counseling.

www.cymricfamilyoffice.com

the family member. If legal or other professional assistance is needed in a transaction, the family office is better prepared to ask for the right assistance and monitor the process since they know the family members' complete financial situation. The family members need only interact with the family office and not a multitude of professionals.

The family office also assists families with generational education by conducting family meetings where the next generation is informed about the financial affairs of the family and their responsibility, if any, in the ongoing process of managing the family's assets. In today's complex and complicated world, the coordinated efforts of a family office can help to maintain the asset base of the family, perpetuate the goals and objectives of the family, and maximize the effectiveness of the professionals required to manage the family's financial lives.

Staying in the Market? Then History is on Your Side

This bear market has been the longest and deepest since the Great Depression. Investors are asking "Is it worth the pain?", and "Will I ever get my money back?" Our answer is, investors need to look at history. For the past 10, 25, and 50 years, the S&P500 has provided

average annual returns of 9%, 13% and 11%. In all those periods, the stock market provided one of the highest returns available to the average individual. Moreover, after every other market decline since 1941, the S&P rose, on average, 140% before the next down year! The smallest rebound was between 1967 and 1968 when the market rose only 37.6%. Even after the "crash" of 1973-1974, the market

rose 70% in 1975-1976, dipped 7.2%, and proceeded up another 67% through 1980.

*"...in the past it
has definitely
paid off for
investors to ride
out the storms
and stay in the
market."*

Therefore, in the past it has definitely paid off for investors to ride out the storms and stay in the market. So the question becomes, Are any of the threats facing us today large enough to change the pattern of the past 10, 25, and 50 years? Many think the answer is an

emphatic "no". Over the 50 years the market has created tremendous wealth even a country faced three wars, away inflation, 10% unemployment, oil embargo, Soviet nuclear warheads, Cuba, the Cold War, and

ROGER ENGEMANN & Associates, Inc.

Roger Engemann & Associates, Inc., founded 1969, specializes in the management of growth-oriented investment portfolios for both individuals and institutions. A proponent of growth-investing, the firm utilizes a fundamental bottom-up approach. Engemann's belief is that consistent rising earnings are the single most significant factor in determining stock prices and that, over time, profitable companies create prosperous investors. A wholly owned subsidiary of Phoenix Investment Partners, the firm currently manages over \$4 billion.

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threat of nuclear annihilation. Certainly we in the United States have critical challenges today, but, given what we have survived and overcome, we believe there are no threats today that are more severe than the pattern of the last 50 years. Therefore, yes, in our opinion, an investor needs to keep money that might be needed in the next couple of years in money markets, or government bonds. However, according to history, in order to stay ahead of inflation and to gain wealth, one had to invest a significant part of one's assets in the market. It is a terrible lesson, although volatile, long-term investment vehicle. The moral is, don't turn your back on history, it remains the best predictor of the future.



GOLDMAN SACHS COULD BE EAGER TO BUY INSTINET'S NETWORK.
WATCH FOR EXACT SCIENCES TO MARKET ITS NEW TEST IN 2003.
SINGING MACHINE: SHORTS MAY GET THE SHORT END OF THE STICK.

GENE G. MARCIAL

Angling for Instinet?

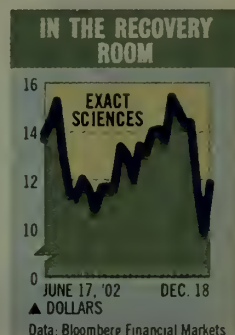
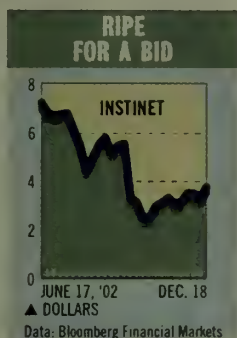
Is Instinet (INET) for sale? It's the No.1 electronic communications network (ECN)—letting investors trade stocks directly. Whispers are that Goldman Sachs is in talks to buy Instinet, 63% owned by Reuters Group, a leader in financial info. One hedge-fund manager, who has bought shares and prefers not to be identified, says Reuters wants to focus on its information business. Standard & Poor's has downgraded Reuters' long-term rating out of concern Reuters may not bounce back soon. Instinet has cut costs, slashed staff by 20%, and closed money-losing fixed-income-trading operations to stay profitable. Through a leveraged purchase of its fiercest rival, Archipelago, Instinet upped its market share from 12% to 30%. Reuters says Instinet must cut 300 more jobs to reduce costs by \$100 million. The cost-cutting has "stopped the bleeding," says John Marrin of Value Line, who says Instinet made a 1¢-a-share third-quarter profit.

The hush-hush talks are likely to bear fruit because Instinet, whose own ECNs—Redi and Archipelago—are just a fraction the size of Instinet, wants to dominate the ECN market," says another source close to the matter. By buying Instinet, Reuters' share would be nearly 50%. Trading at 3.76—down from a high of 19 in January, 2001—Instinet is worth about \$25 in a buyout, says this pro. "Goldman is determined to buy, and Reuters seems ready to sell," he argues. Thomson Financial/First Call estimates Instinet will break even in 2003, vs. making 72¢ a share in 2000 and 63¢ in 2001. It sees a 2003. Both Goldman and Reuters declined comment.

From Exact Sciences, A Better Cancer Test

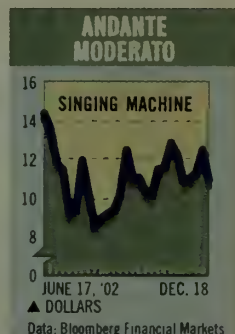
Some pros are getting bullish on Exact Sciences (EXAS), a little-known biotech whose PreGen-Plus appears to be the most effective noninvasive test for colorectal cancer. PreGen-Plus is expected to be on the market in the first half of 2003. The first clinical trial for PreGen-Plus showed that its diagnoses were accurate 95% of the time—much higher than for existing tests, says Gene Marondel of securities firm Gerard Klauer Mattison, who rates the stock a buy. The data confirm previous results

that PreGen-Plus is an "accurate, safe, and noninvasive new screening method for early detection of colorectal cancer," says Marondel. The test isolates DNA from stool samples to identify genetic changes associated with cancer. In July, Exact's stock was at 17 before it slid on reports by the shorts that it was overvalued, says Pete Donaldson, also of Gerard. Some 1.6 million shares, 10% of shares outstanding, have been shorted. The stock is now at 10.91, but Marondel thinks it is worth 20. She figures Exact will turn profitable in 2005, earning 98¢ a share. One of the current tests, fecal occult blood testing, has disadvantages PreGen-Plus doesn't have, such as high rates of false positives, says Matt Geller of CIBC World Markets, who rates Exact an "overweight."



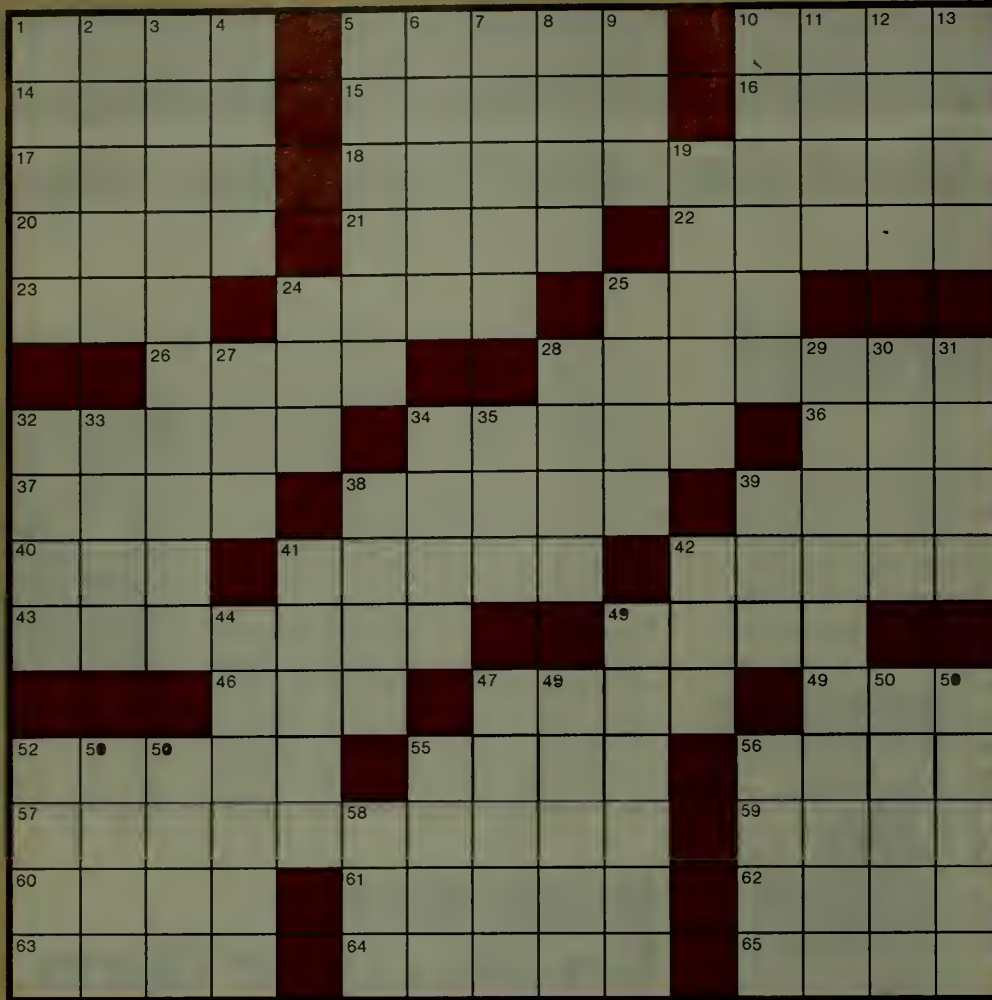
Singing Machine May Join a Larger Chorus

The shorts are all over Singing Machine (SMD), although the karaoke king is still belting out robust sales and earnings. The stock has dropped to 10.90, down from its 52-week high of 19.14 in March. When featured in this column on June 29, 2002, the stock was at 9—rising to 13 in September. But the short-sellers, having shorted 600,000 of the 4.5 million shares in public hands, may get the short end of the stick. Some bulls are sure management will sell off Singing Machine—either a hefty chunk or all of it—to a big entertainment outfit. Asked which possibility he prefers, Chairman Ed Steele said: "I'll take whichever comes first." He has hired investment banker A.G. Edwards to handle things. "Demand is exploding," says President John Klecha. "Best Buy, Circuit City, and Toys 'R Us are selling our karaokes as fast as they get them in. More shipments are coming from our Hong Kong manufacturers, but we need capital to increase production." He sees sales of \$110 million to \$120 million for fiscal 2003 ending Mar. 30, vs. last year's \$62 million, and earnings of \$1.60 to \$1.70 a share, vs. 2002's \$1.02.



BusinessWeek online Read Gene Marcial's Inside Wall Street Online column Tuesday afternoons at www.businessweek.com/today.htm. And see him Fridays at 1:40 p.m. EST on CNN's *The Money Gang*.

Mixing Business with Pleasure by Lincoln



ACROSS

1. NCR products
5. CPI and GDP
10. Word on every dollar
14. Warm and cozy
15. Travel-agent offerings
16. Chicago Cubs star
17. Revolver inventor
18. Office-party occasion
20. LL.D. holders
21. Senior lobby
22. Passport stamps
23. Louvre Pyramid architect
24. Customs charge
25. Hit the jackpot
26. Hershey competitor
28. Aviator has 3rd-row ____ (see page at right)
32. AOL customers
34. Skiers' mecca
36. PBS benefactor
37. Carmine and cherry
38. Former Cologne currency
39. ____-loss order
40. Maui souvenir
41. Something signed by shareholders
42. Philanthropist Hopkins
43. "Like Navigator, only ____" (see page at right)
45. Headquarters

46. Gresham's ____
47. Arabian nation
49. Logan Airport, on luggage tags
52. DuPont refrigerator
55. State confidently
56. ____ mater
57. Financial success, so to speak
59. Sheep sounds
60. Big Apple's Finest: Abbr.
61. Word before sense or trader
62. Onetime New York Times publisher
63. Nine-digit IDs: Abbr.
64. Computer keyboard key
65. Sign off on

DOWN

1. Music-royalty collector
2. Seven-year security
3. Like some presentations
4. Some noncoms: Abbr.
5. Onetime Macy's owner
6. Have a bite ____
7. He sold the Angels to Disney
8. Junket
9. Ukraine's former designation: Abbr.
10. Money-making operation
11. Thumbs-down votes
12. Annapolis school: Abbr.
13. Gym surfaces
19. French resort
24. JAMA readers
25. Pay period, often
27. "____ gratia artis" (MGM motto)
28. Agile
29. Profitable
30. Light gas
31. Disruptions
32. Internet addresses, for short
33. Appear to be
34. Love, in Spain
35. Jazz instrument
38. Sketched
39. Distress signal
41. Architectural drawings
42. Calendar abbreviation
44. World's largest insurance exchange
45. Cashless transaction
47. In the open
48. Reagan attorney general
50. Buffett's home
51. Impertinent
52. Swamplands
53. Sunbeams
54. Network 20%-owned by Hearst
55. Elvis' middle name
56. Peek-____
58. ____ end

For answers to this puzzle:

Turn to page 167 in this week's issue of BusinessWeek or access Mixing Business with Pleasure by Lincoln through any PDA*. Visit businessweek.com/lincoln/ and enjoy 8 puzzles over the next 2 months.

Puzzle created by: Stanley Newman.

* Palm OS™ or Pocket PC™ digital assistant



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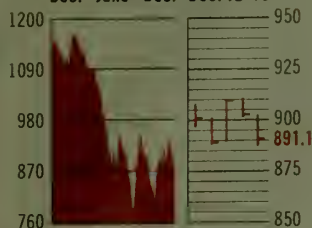
Genes? Yes.
Clone? No.



STOCKS

S&P 500

Dec. June Dec. Dec. 12-18



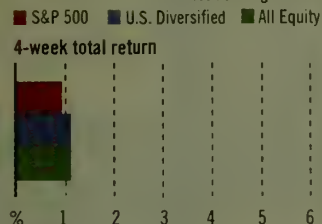
COMMENTARY

As the U.S. edged closer to a declaration of war on Iraq, Treasuries climbed sharply and stocks continued to slide. Still, contrarians were busy buying in the belief that sellers are overreacting. Oracle's Dec. 18 earnings announcement that quarterly profits were flat lent support to that view. For the week, NASDAQ fell 2.5%, followed by the Dow, off 1.7%, and the S&P 500, off 1.5%.

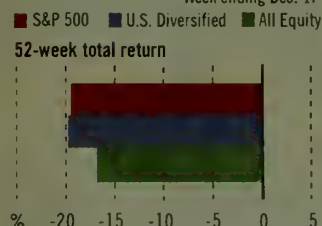
Data: Bloomberg Financial Markets (Reuters)

MUTUAL FUNDS

Week ending Dec. 17



Week ending Dec. 17



Data: Standard & Poor's

THE WEEK AHEAD

PERSONAL INCOME Monday, Dec. 23, 8:30 a.m. EST ► Personal income is forecast to have increased by 0.3% in November, after rising 0.1% in October. That's according to the median forecast of economists surveyed by MMS International. Consumer expenditures most likely rose by 0.5% during the month, following a 0.4% increase in October. Consumers are still spending at healthy clip, with purchases in October up 3.7% from a year ago, underpinned by steady growth in personal incomes.

DURABLE GOODS ORDERS Tuesday, Dec. 24, 8:30 a.m. EST ► New orders for durable goods most likely increased 0.4% in November. A broad upturn in orders for capital goods helped push durable goods orders up a strong 2.4% in October.

EXISTING HOME SALES Thursday, Dec. 26, 10 a.m. EST ► Existing home sales likely eased to an annual pace of 5.7 million in November. In October, sales came in at an annual rate of 5.77 million. Low interest rates and steady income growth are help-

ing propel the 2002 housing market to a record level of sales, which should reach 5.6 million homes.

NEW RESIDENTIAL SALES Friday, Dec. 27, 10 a.m. EST ► New single-family sales for November are expected to reach an annual rate of 1 million units, the fourth straight month of a pace of 1 million homes or better. When 2002 wraps up, annual sales are likely to exceed 960,000 units, a record for housing.

U.S. MARKETS

	DEC. 18	WEEK	YEAR TO DATE	LAST 12 MONTHS
S&P 500	891.1	-1.5	-22.4	-22.0
Dow Jones Industrials	8447.4	-1.7	-15.7	-15.5
NASDAQ Composite	1361.5	-2.5	-30.2	-32.1
S&P MidCap 400	430.0	-1.7	-15.4	-14.5
S&P SmallCap 600	197.1	-1.9	-15.1	-14.0
Wilshire 5000	8431.3	-1.5	-21.3	-20.7

SECTORS

	DEC. 18	WEEK	YEAR TO DATE	LAST 12 MONTHS
BusinessWeek 50*	548.4	-1.7	-24.9	-23.9
BusinessWeek Info Tech 100**	292.1	-2.0	-30.3	-32.1
S&P/BARRA Growth	455.3	-2.5	-23.4	-23.9
S&P/BARRA Value	432.7	-0.5	-21.6	-20.4
S&P Energy	186.3	0.5	-11.8	-7.5
S&P Financials	301.9	-1.1	-15.0	-13.5
S&P REIT	89.7	-1.0	-4.0	-3.9
S&P Transportation	171.2	-0.9	-13.1	-13.5
S&P Utilities	97.3	3.1	-33.3	-29.3
GSTI Internet	77.8	-1.9	-25.9	-27.1
PSE Technology	466.7	-2.0	-32.1	-34.0

*Mar. 19, 1999 = 1000 **Feb. 7, 2000 = 1000

BEST-PERFORMING GROUPS

	LAST MONTH %		LAST 12 MONTHS %
Paper Packaging	25.2	Metal & Glass Containers	31.2
Gold Mining	19.5	Gold Mining	20.2
Constr. & Engineering	15.7	Photographic Products	19.1
Fertilizers & Ag. Chems.	14.9	Housewares & Specialties	15.6
Oil & Gas Refining	14.1	Food Wholesalers	12.1

EQUITY FUND CATEGORIES

4-WEEK TOTAL RETURN	%	52-WEEK TOTAL RETURN	%
LEADERS		LEADERS	
Precious Metals	12.6	Precious Metals	58.9
Natural Resources	7.6	Real Estate	3.9
Latin America	7.3	Natural Resources	1.7
Utilities	4.5	Diversified Emerging Mkts.	-0.9
LAGGARDS		LAGGARDS	
Europe	-1.6	Technology	-40.9
Health	-1.2	Communications	-38.7
Foreign	-0.7	Health	-28.3
Large-cap Growth	-0.4	Small-cap Growth	-25.8

EQUITY FUNDS

4-WEEK TOTAL RETURN	%	52-WEEK TOTAL RETURN	%
LEADERS		LEADERS	
U.S. Gl. Wid. Pr. Minls.	16.4	First Eagle SoGen Gold	94.0
U.S. Global Investors Gold	16.2	Monterey OCM Gold	75.7
Van Eck Intl. Invs Gold A	15.3	Gabelli Gold	75.5
Amer Century Gl. Gold Inv.	14.8	Tocqueville Gold	74.2
LAGGARDS		LAGGARDS	
American Heritage	-22.2	ProFunds UltraWriss. Serv.	-74.6
Van Kampen Intl. Advge. A	-6.6	ProFunds UltraOTC Inv.	-69.1
Rydex Dynam. Vent. 100	-6.6	Rydex Dynam. Veloc. 100	-68.1
ProFunds UltraSh. OTC Inv.	-6.5	ProFunds UltraSemicdr. Inv.	-67.8

GLOBAL MARKETS

	DEC. 18	WEEK
S&P Euro Plus (U.S. Dollar)	840.4	-1.8
London (FT-SE 100)	3835.2	-3.5
Paris (CAC 40)	3077.4	-3.5
Frankfurt (DAX)	3022.7	-5.4
Tokyo (NIKKEI 225)	8344.0	-4.4
Hong Kong (Hang Seng)	9548.7	-2.4
Toronto (S&P/TSX Composite)	6560.9	-0.4
Mexico City (IPC)	6089.7	0.1

FUNDAMENTALS

	DEC. 17	WK. AGO
S&P 500 Dividend Yield	1.75%	1.7
S&P 500 P/E Ratio (Trailing 12 mos.)	29.2	29.
S&P 500 P/E Ratio (Next 12 mos.)*	16.4	16.
First Call Earnings Revision*	-1.95%	-2.0

TECHNICAL INDICATORS

	DEC. 17	WK. AGO
S&P 500 200-day average	971.0	976.
Stocks above 200-day average	29.0%	28.
Options: Put/call ratio	0.75	0.7
Insiders: Vickers NYSE Sell/buy ratio	2.33	1.9

WORST-PERFORMING GROUPS

	LAST MONTH %		LAST 12 MONTHS %
Agricultural Products	-10.7	Multi-Utilities	
Semiconductor Equip.	-10.5	Tires & Rubber	
Health-Care Services	-10.1	IT Consulting	
Movies & Entertainment	-10.0	Instrumentation	
Employment Services	-9.9	Telecomms. Equip.	

INTEREST RATES

KEY RATES

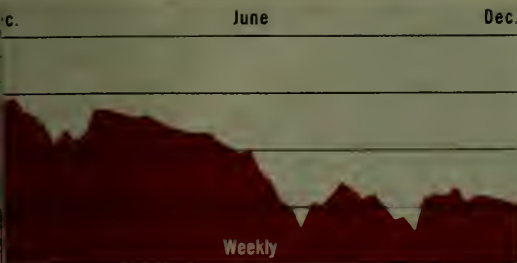
	DEC. 18	WEEK AGO
MONEY MARKET FUNDS		
90-DAY TREASURY BILLS	1.08%	1.11%
2-YEAR TREASURY NOTES	1.20	1.19
10-YEAR TREASURY NOTES	1.77	1.85
30-YEAR TREASURY BONDS	4.03	4.02
30-YEAR TREASURY BONDS	4.96	4.88
30-YEAR FIXED MORTGAGE†	6.00	6.02

BLOOMBERG MUNI YIELD EQUIVALENTS

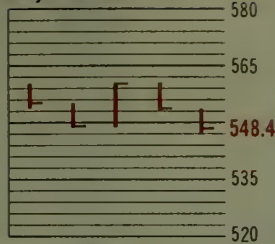
Taxable equivalent yields on AAA-rated, tax-exempt municipal bonds, assuming a 30% federal tax rate

	10-YR. BOND
GENERAL OBLIGATIONS	3.86%
TAXABLE EQUIVALENT	5.51
INSURED REVENUE BONDS	3.98
TAXABLE EQUIVALENT	5.69

BUSINESSWEEK FIFTY



Daily: Dec. 12-18



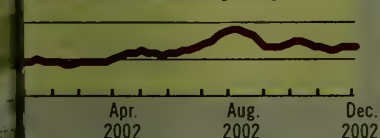
0 declined 1.7% for the week ending Dec. 18. KLA-Tencor, the maker of chip-monitoring equipment, along with other tech capital-equipment makers despite little in the way of hard news. On the brighter side, KB Home rose 6.9% and KB Home rose 6.2% respectively on news housing starts were up 2.4% in Forest Laboratories' announcement of a 2-for-1 stock split added another 4.1% to the share price.

PERFORMANCE			% CHANGE			% CHANGE		
COMPANY	WEEK	SINCE 3/1/02	RANK	COMPANY	WEEK	SINCE 3/1/02		
son & Johnson	-4.4	-11.8	26	Tenet Healthcare	-0.9	-55.5		
die Mac	1.9	-5.5	27	Household International	-0.6	-46.0		
r	-4.2	-26.1	28	WellPoint Health Networks	-0.8	15.4		
A	-2.4	-15.6	29	Washington Mutual	-1.3	10.4		
o Morris	1.2	-21.5	30	Duke Energy	1.8	-44.2		
encor	-8.2	-38.0	31	Kohl's	-4.5	-13.2		
ie Mae	3.0	-13.7	32	Bed Bath & Beyond	-2.5	-3.2		
s	-4.0	-15.6	33	Cardinal Health	-3.6	-9.9		
Buy	-3.9	-45.3	34	Centex	6.7	-12.4		
sourceBergen	-3.5	-18.5	35	American Electric Power	4.8	-37.3		
dHealth Group	-1.3	13.1	36	Golden West Financial	0.1	11.8		
n	0.0	5.5	37	Stryker	0.9	7.1		
Depot	-4.9	-49.1	38	Harley-Davidson	-4.5	-9.5		
art Stores	-3.1	-18.8	39	PepsiCo	-5.3	-19.1		
zy	9.2	-95.8	40	Merck	-2.6	-7.3		
al Dynamics	-3.2	-14.0	41	Apache	1.6	9.4		
oPhillips	-0.6	-16.6	42	Amerada Hess	-3.8	-19.5		
t Laboratories	4.1	22.4	43	KB Home	6.2	0.5		
(H&R)	2.1	-20.5	44	First Data	0.2	-10.6		
ie	-3.7	-54.0	45	Tyco International	-0.1	-41.6		
ental Petroleum	1.6	6.3	46	International Game Technology	-3.1	7.3		
	-1.0	-0.2	47	Capital One Financial	-4.8	-37.8		
Homes	6.9	-7.4	48	Electronic Data Systems	-2.3	-68.9		
hon Oil	0.5	-22.7	49	Nabors Industries	2.2	3.1		
up	2.5	-12.4	50	Xcel Energy	5.1	-54.3		

PRODUCTION INDEX

Change from last week: 0.2%
Change from last year: 2.8%

INDUSTRIAL OUTPUT Dec. 7=163.1 1992=100
The index is a 4-week moving average



tion index bounced back during the latest calculation of the four-week moving average rose to 163.3, from 162.6. On a seasonal basis, lumber and rail-freight traffic led higher with significant rebounds. Truck and electric power production also made a contribution. Autos and crude-oil refining were laggards, while steel and coal also showed declines.

Each of the index components is at www.businessweek.com
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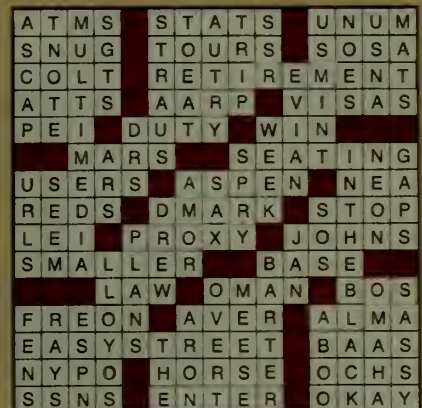
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WHAT WE LEARNED IN 2002

The year 2002 won't be missed by many. Shell-shocked investors withdrew from the markets to nurse wounded feelings of loss and betrayal. A stunned corporate elite retreated to ponder the plunge in respect it suffered from a wave of business scandals. If 2001 was a wild ride caused by a bursting tech bubble—and exacerbated by September 11—then 2002 was a painful learning experience for a chastened nation. We began to understand just what went wrong in the '90s boom when the excess started.

As the new year begins, let's reflect on what we learned over the past 12 months. The lessons are sobering, and should motivate us to complete the job of restoring the checks and balances of our capitalist system—in corporate governance, accounting, Wall Street, and government regulation—that so failed us. The stakes are high. Risk-taking is a quintessentially American trait and plays a large role in its economic success. But over the past year it has been replaced by risk-aversion and extreme caution. Unless investor trust is restored and confidence returns to the managers of Corporate America so that they are willing to invest for the future, no amount of tax-cutting can restore the U.S. to its true economic potential.

LESSON No. 1: The problems revealed by the scandals were systemic, not the result of a few bad apples. While only a few CEOs may go to jail for breaking the law, the breakdown was endemic to both the corporate and financial systems. Most CEOs, not just a few, were overcompensated for success and protected from failure. Many, not just a few, accountants, analysts, attorneys, regulators, and legislators failed, to one degree or another, in ensuring the accuracy of financial statements and the free flow of honest data in the markets.

LESSON No. 2: Regulation matters. The failure to set rules in new markets cost investors and consumers billions of dollars. The absence of virtually any regulation in Internet energy-trading markets led to false shortages, fake trades, huge profits, and enormous financial and economic losses in California. Deregulation should not mean anarchy, deceit, and greed hiding behind a twisted interpretation of Chicago School economic theory. Markets need clear rules and policing to be open, transparent, and fair.

LESSON No. 3: On Wall Street, conflicts of interest are not synergy, as Jack Grubman would have it. Analysts who sit in on board meetings, go on road shows, mislead individual investors, and feign objectivity on CNBC but get paid for generating investment banking business are not being synergistic. They are being corrupt. Separation of financial activities, solid Chinese Walls and, above all, serious managing of conflicts of interest are crucial to the honest operation of capital raising and investment in the economy.

LESSON No. 4: Boards count. The most important check on CEO behavior is the board of directors. The failure of

boards to do their job as shareholder representatives—advocates—was a major cause of corporate scandal in 2002. Many boards condoned outlandish CEO demands for millions of options, personal loans, repricing of underwater options, loose accounting, and, in the case of Enron Corp., deliberate abandoning the corporate code of ethics. Independent board members heading audit and compensation committees are essential to the proper functioning of companies. Separating the function of CEO and chairman, who oversees the CEO, may be needed at some companies.

LESSON No. 5: CEO pay is too high. Execs weren't entitled to become super-rich in the roaring '90s and are certainly not today. In the past decade, companies that granted 90% of options to CEOs and a few top managers performed worse than those that distributed options more evenly and broadly among employees. There is no justification for increasing the compensation of CEOs from 40 times that of the average employee in the '60s to nearly 600 times today. Stock prices have come down since the bubble burst, investors have lost billions, people have been laid off, retirement funds have been cut, and profit projections have been trimmed. CEO pay remains sky-high. This is untenable.

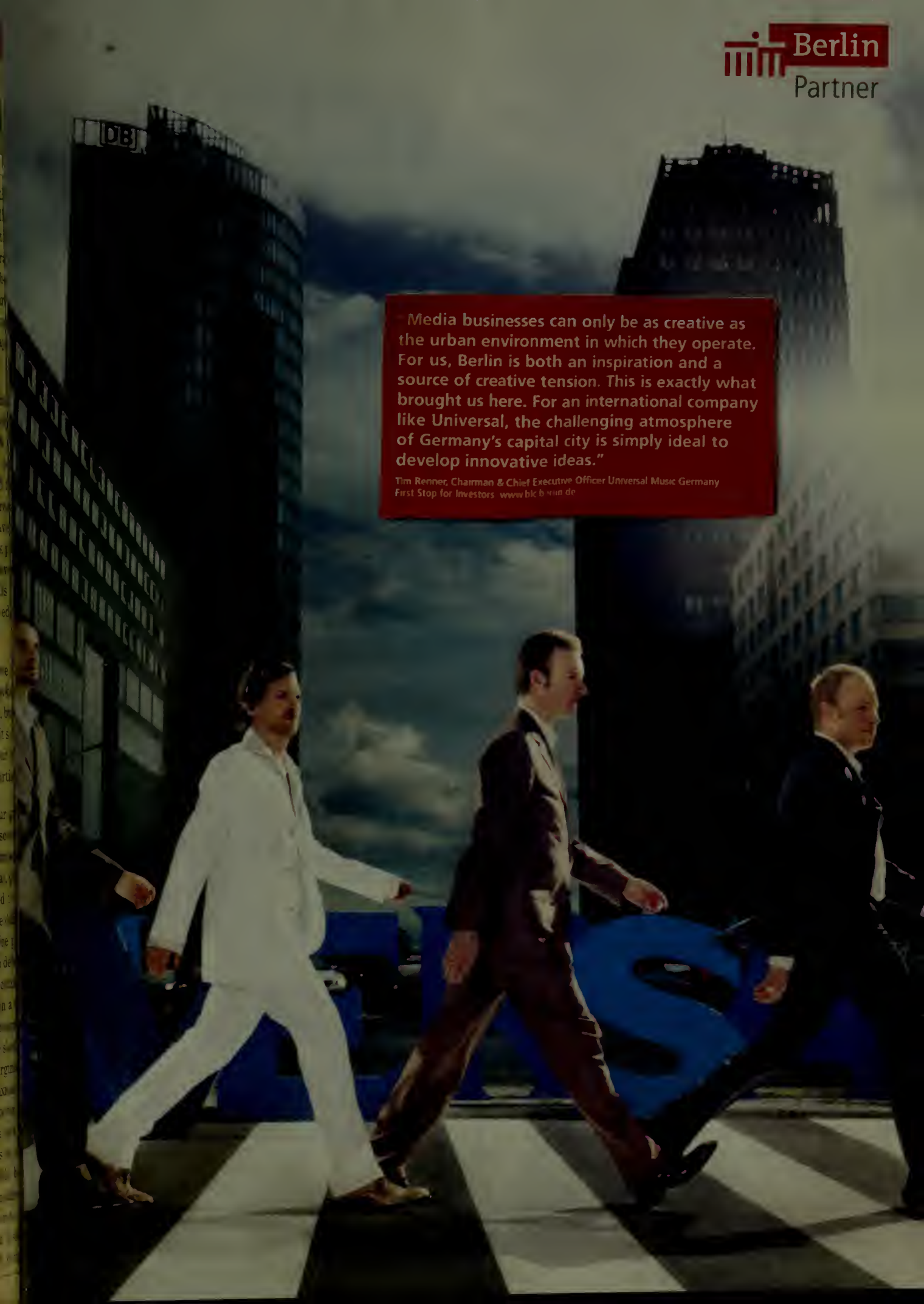
LESSON No. 6: We know a lot less than we think we do about economic policy. Supply-siders and deficit hawkdom rule over tax cuts, deficits, interest rates, and growth, but neither side has the economic theory or data to prove it's right. The failure of economic theory to decide key economic issues makes policy-making extremely ideological and partisan.

LESSON No. 7: Deflation is the new enemy. Our grandparents knew this from the '30s, but we're only discovering it now. Technology, higher productivity, greater competition, and globalization (meaning huge imports from China), plus inflation-fighting monetary policies, have combined to make many prices lower, perhaps too low. Companies have difficulty generating profits partly because they can't raise prices. Without officially saying so, the Fed has gone into deflation-fighting mode, flooding the economy with money, cutting interest rates, and allowing the dollar to fall 5% on a trade-weighted basis this year. The result? Nonoil commodity prices and prices for imported consumer goods are slowing, helping companies to rebuild their profit margins.

This Christmas season finds most Americans anxious about their economic future. They should take heart, however, from the fact that the markets in 2002 began to develop a new, solid foundation for future gains. There is a focus on companies with real assets and simple, comprehensible balance sheets with reasonable valuations. Checks and balances are being restored in the financial system and corporate governance is improving. We learned some difficult lessons in 2002, and 2003 is going to be better. Maybe a lot better.

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